

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY)	
Proposed General Increase in Rates for Gas Service)	
)	Docket No. 12-0511
THE PEOPLES GAS LIGHT AND COKE COMPANY)	and No. 12-0512
Proposed General Increase in Rates for Gas Service)	Consolidated
)	

REBUTTAL TESTIMONY OF MICHAEL L. BROSCHE
ON BEHALF OF THE
PEOPLE OF THE STATE OF ILLINOIS

Dated: January 16, 2013

DIRECT TESTIMONY OF MICHAEL L. BROSCHE

TABLE OF CONTENTS

I.	INTRODUCTION / SUMMARY.....	5
II.	AVERAGE RATE BASE.....	5
III.	FORECASTED LABOR EXPENSES.	14
IV.	PRODUCTIVITY FORECAST ASSUMPTIONS.....	21
V.	INCENTIVE COMPENSATION.....	28
VI.	STATE INCOME TAX RATE ISSUE.....	34
VII.	INVESTED CAPITAL TAX.....	42
VIII.	CHICAGO DOT REGULATIONS & CROSS BORES.	45
IX.	AFFILIATE O&M EXPENSE ADJUSTMENTS.....	50
X.	CASH WORKING CAPITAL.....	57
XI.	COST OF CAPITAL.	66
XII.	CONCLUSION AND RECOMMENDATION.....	71

EXHIBIT LIST

- AG Exhibit No. 4.1 Revised PGL Revenue Requirement Schedules
- AG Exhibit No. 4.2 Revised NSG Revenue Requirement Schedules
- AG Exhibit No. 4.3 Response to AG 16.01.
- AG Exhibit No. 4.4 Responses to AG 16.09, 16.10, 16.11(supp),16.12 and 16.13.
- AG Exhibit No. 4.5 Responses to Data Requests AG 8.10, 8.20, 10.13 and 10.28.
- AG Exhibit No. 4.6 Response to Data Request AG 16.25.
- AG Exhibit No. 4.7 Responses to Data Request AG 13.11 and AG 12.13.
- AG Exhibit No. 4.8 Response to Data Request AG 13.16.
- AG Exhibit No. 4.9 Response to Data Request AG 13.10.
- AG Exhibit No. 4.10 Response to Data Request AG 16.21 and Excerpts from WPB-08.
- AG Exhibit No. 4.11 Response to Data Request AG 7.34 with Attachment 8.

TABLES LIST

- TABLE 1: MAXIMUM INCREASE IN PRESENT BASE RATES (NON-GAS).
- TABLE 2: EMPLOYEE VACANCY FACTORS IN HAWAII RATE CASE FORECASTS.
- TABLE 3: ACTUAL CDOT COMPLIANCE EXPENSE TRENDS/COMPARISONS.
- TABLE 4: RISK FREE INTEREST RATES SINCE PRIOR RATE ORDER

I. INTRODUCTION / SUMMARY

1 **Q. Please state your name and business address.**

2 A. My name is Michael L. Brosch. My business address is PO Box 481934, Kansas
3 City, Missouri 64148-1934.

4
5 **Q. Are you the same Michael L. Brosch who previously submitted Direct**
6 **Testimony on behalf of the People of the State of Illinois represented by the**
7 **Attorney General, (“Attorney General” or “AG”) in these Dockets?**

8 A. Yes. My qualifications were presented as AG Exhibits 1.1 and 1.2 with that
9 previously submitted testimony.

10 **Q. What is the purpose of your Rebuttal Testimony?**

11 A. My Rebuttal Testimony is responsive to the arguments raised by certain of Peoples
12 Gas Light & Coke Company (“PGL”) and North Shore Gas Company (“NSG”,
13 collectively the “Companies” or “Utilities”) witnesses regarding ratemaking
14 positions and adjustments that were presented in my Direct Testimony. I have
15 prepared this Rebuttal Testimony in the same sequence as my prior Direct
16 Testimony.

17 **Q. Have you updated and revised the AG Accounting Schedules that were**
18 **previously submitted as AG Exhibit 1.3 and AG Exhibit 1.4 for PGL and NSG,**
19 **respectively?**

20 A. Yes. I have prepared and will explain the attached AG Exhibit 4.1 and AG Exhibit
21 4.2, which contain corrected and updated calculations of the AG-recommended
22 revenue requirement for PGL and for NSG, respectively. These two new exhibits
23 are intended to replace the corresponding AG Exhibits 1.3 and 1.4 that were

presented and explained in my Direct Testimony, and the Direct Testimony of David Effron. The accounting Schedules within AG Exhibits 4.1 and 4.2 have been marked “revised” or “new” with cell shading to indicate where input changes or revisions have been made to the AG adjustments therein.¹

Q. What information have you relied upon in formulating your Rebuttal Testimony recommendations?

A. I have relied upon the Companies’ pre-filed Direct and Rebuttal testimony and exhibits in these Dockets, as well as the Company’s responses to data requests submitted by Staff, the AG and other parties. I also rely upon my prior experience with the regulation of public utilities over the past 34 years, including significant experience in Illinois, as more fully described in my Direct Testimony.

Q. What is the starting point for the revised and updated revenue requirement calculations that you sponsor?

A. I have revised the input value starting data for the AG’s updated and revised revenue requirement calculations within AG Exhibits 4.1 and 4.2, using the Companies’ Rebuttal Exhibits, including NS-PGL Ex. 26.1P and 26.1N for Operating Income, NS-PGL Ex. 27.1P and 27.1N for Rate Base and NS-PGL 23.1P and 23.1N for Cost of Capital. This revised starting data for AG Exhibits 4.1 and 4.2 incorporates all the changes made by the Companies’ to their asserted revenue requirement positions in Rebuttal. From this revised input data, AG Schedule B (Rate Base), Schedule C (Operating Income) and Schedule D (Cost of Capital) reflect the posting of each of the AG-proposed adjustments separately set forth on Schedule labeled B-1, B-2, etc. and C-1, C-2, etc., for Rate Base and Operating

¹ The summary schedules that are derived from adjustment revisions are not shaded or marked as revised so as to focus attention upon only substantive changes to AG calculations.

47 Income, respectively. Where changes have been made to specific adjustment
48 calculations, the adjustment schedule are marked as “Revised” and if a completely
49 new adjustment is now needed, it has been inserted and marked as “New”. Along
50 with the AG ratemaking adjustments proposed for Rate Base and Operating
51 Income, I continue to include proposed revisions to the cost of long term debt in
52 Schedule D and have retained the Return on Equity (“ROE”) of 9.45% that was
53 approved by the Commission for the Companies in Docket Nos. 11-0280/11-0281,
54 consolidated.² As in my Direct Testimony, an index appears as the first page of AG
55 Exhibits 4.1 and 4.2 to identify each schedule and its sponsoring witness.

56 The revised level of AG-proposed maximum revenue requirements is
57 summarized on Schedule A, reflecting the posting of all of the AG-proposed
58 adjustments at Schedule B, page 2 and Schedule C, pages 2 and 3, along with the
59 AG recommended Cost of Capital from Schedule D. Each of the revisions to the
60 Company’s Rebuttal Testimony and Exhibits is described in more detail in my
61 Direct Testimony and in Mr. Effron’s Direct Testimony (AG Exhibit 5.0).

62 **Q. Please summarize the recommendations that are set forth in your testimony.**

63 A. The overall revenue increase for PGL and NSG *should not exceed* the amounts set
64

² Docket Nos.11-0280/11-0281 cons., Final Order at page 145.

65 forth in the following table:

66 TABLE 1: MAXIMUM INCREASE IN PRESENT BASE RATES (NON-GAS)

Total Revenue Increase \$Millions	Peoples Gas	North Shore Gas
AG Rebuttal Proposed ³	\$ 15.4	\$ 2.6
Company Rebuttal Proposed ⁴	\$106.9	\$11.6
Difference	\$ 91.5	\$ 9.0

67

68 As previously noted in my Direct Testimony, the adjustments we are proposing
69 should be viewed as cumulative with the work and recommendations of
70 Commission Staff and other intervenors' witnesses.

71 **Q. Is any element of the revenue requirement calculation logic that was employed**
72 **in AG Exhibits 1.3 and 1.4 and again in AG Exhibits 4.1 and 4.2 disputed by**
73 **the Companies?**

74 A. Yes. Ms. Sharon Moy states her disagreement with the Gross Revenue Conversion
75 Factor set forth at Schedule A-1, where part of the required revenue increase is
76 satisfied by a ratable increase in Late Payment Charge revenues as described in
77 footnote (c) on AG Schedule A-1. According to Ms. Moy, "The Utilities have
78 already accounted for the fact that every dollar of incremental base rate revenue will
79 create incremental late payment charge revenues in the revenue requirement. Thus,
80 Mr. Brosch's adjustment would result in double counting."⁵

81

³ AG Proposed amounts reflect only ratemaking adjustments proposed by AG witnesses. The AG's final position on revenue requirement issues may include consideration of adjustments proposed by Staff or other intervenors' witnesses.

⁴ Company proposed amounts reflect Rebuttal Direct Testimony revisions.

⁵ NS-PGL Ex. 26.0, page 12, line 245.

82 **Q. Is there any “double counting” of incremental Late Payment Charge revenues**
83 **under the AG’s approach?**

84 A. No. While it is true that PGL and NSG have accounted for incremental Late
85 Payment Charge revenues arising from the rate increase at NS-PGL Ex. 26.1P/N in
86 column (F) at line 10, it is important to note that the starting point for the AG’s
87 revenue requirement calculations is column (E) of this Exhibit, which is prior to
88 such incremental Late Payment Charge revenues. This fact can be verified by
89 looking at AG Exhibit 4.1 in Schedule C, where PGL’s “Other Revenues” in
90 column (B) are \$15,386 (thousand) which does not include the incremental \$885
91 (thousand) of incremental Late Payment Charge revenues arising from PGL’s
92 proposed revenue increase. An accounting for these “Other Revenues” is therefore
93 needed in AG Schedule A-1, the Gross Revenue Conversion Factor, to accomplish
94 the same accounting for incremental Late Payment Charge revenues from the
95 revenue increase that the Companies apparently agree should be recognized. The
96 “AG Proposed” revenue conversion factor on Schedule A-1 includes a factor at line
97 2 to “Add: Other Operating Revenues” that has the effect of including Late
98 Payment Charge revenue growth associated with the AG-proposed revenue
99 requirement, which amounts then appear in Schedule C, page 1, column (E), line 3
100 for each of the Companies.

101
102 **II. AVERAGE RATE BASE.**

103
104 **Q. In Direct Testimony, the AG, CUB/City of Chicago and Staff witnesses all**
105 **recommended utilization of an average rate base in calculating revenue**

requirement using a forecasted test year. How have the Companies' witnesses responded in their Rebuttal to this proposal?

A. James Schott's Rebuttal Testimony characterizes use of the average rate base by Staff and intervenor witnesses as "reductions in the Utilities' recovery of the costs of plant investments" He also states that customers "also face the risk of increased costs of capital"⁶ as well as fewer construction jobs.

Mr. Schott also argues that the logic associated with using an average rate base implicitly assumes that "the utility has in place throughout that year rates that reflect its costs during that year", and that, "the average rate base methodology, of necessity, denies the Utilities recovery of a substantial part of their 2013 costs."⁷

Q. Does use of an average rate base methodology deny the Utilities recovery of a substantial part of their 2013 costs?

A. No. An average rate base affords a reasonable opportunity for the Companies to recover the overall costs incurred to provide service. An average rate base, when used with a forecasted or future test year, properly matches the level of investment throughout the year with the related levels of sales, revenues, operating expenses, depreciation expenses, taxes and cost of capital that have been measured on an average, rather than year-end, basis of accounting. For example, the Utilities' cost of debt capital is expected to decline at the dates of each scheduled long term debt refinancing, but both PGL and NSG have calculated and used an average cost of debt throughout the test year, rather than annualizing the lower long term debt costs expected to exist at year-end. It is fundamentally unfair to ratepayers for the Companies to recover a higher cost of long term debt using average test year costs

⁶ *Id.* at lines 124-126.

⁷ *Id.* at lines 175-184.

and then assert an entitlement to year-end rate base investment levels that are expected to be higher than average levels. As explained in my Direct Testimony, it is important to maintain a matched and internally consistent methodology in calculating test year revenue requirement to avoid distorting and overstating the revenue requirement.

Q. Will approval of an average rate base approach “reduce dramatically the Utilities’ investments allowed in rate base, especially Peoples Gas’ Accelerated Main Replacement Program (“AMRP”) projects” as indicated by Mr. Schott?

A. Not at all. There is no disallowance of any actual investments caused by utilization of an average rate base. Mr. Schott has identified no actual investments that have actually been made by the Utilities and that are excluded from rate base under the AG’s proposals. What is “reduced” in the AG’s filing is the Companies’ intended overstatement of rate base that is caused by projecting plant additions further into the future than the balance of the other operating income and capital structure inputs to the test year revenue requirement calculation. Separate adjustments to PGL’s rate base associated with PGL’s projected CWIP amounts proposed by Mr. Effron are unrelated to the need for the Commission to calculate the Companies’ rate base using average plant figures, rather than year-end amounts.

Q. Is the ability in Illinois to employ a forecasted test year beneficial to public utilities in the State?

A. Yes. The ability to employ a forecasted test year offers the considerable advantage to the Utilities of being able to include in their rates estimated costs for planned new investments that represent costs not yet incurred. Thus, the average versus year-end rate base dispute involves no actual costs that have been incurred by the

Utilities’, but instead involves only a question of how far into the future we include speculative estimates of future investments that have only been budgeted by the Utilities. In contrast, if an historical rate base were employed, ratepayers would be assured of paying a return on only actual, incurred levels of plant investment, rather than uncertain estimates of future investments that are only planned to be made. In this sense, use of an average rate base reduces the risk to ratepayers of overstating the estimates of future investments that are expected to be made in the forecasted test year. The bottom line is that utilization of forecasted levels of rate base and expenses results in minimal regulatory lag to the considerable advantage of utility investors.

Q. Will the Companies be denied an opportunity to earn a return on all of their prudently invested capital that is used to construct new utility plant under the AG’s proposed continuation of average rate base methodologies?

A. No. The continuous capital spending incurred by the Companies is common throughout the gas utility industry and results in the addition of new utility plant assets that are long-lived. New plant assets that are acquired or constructed by the Utilities will be includable in rate base for decades into the future. When PGL and NSG add new plant investments that cumulatively exceed the estimated average investment amounts included in rate base by the AG, the Companies will retain the opportunity and can be expected to seek rate base inclusion for all such incremental investments in many future rate cases during the decades that new plant remains in service. There is no permanent loss of return on investment in new plant because all new investments in long-lived plant assets are recorded on the Utilities’ books

176 and can be included in rate base within all future test years while the plant remains
177 in service.

178 **Q. Is there any disallowance of plant investment when new plant is added between**
179 **test years, or in this case, when new plant is added that eventually exceeds the**
180 **calculated average of forecasted test year investment levels?**

181 A. Not at all. Ratemaking need not continuously capture growth in rate base to
182 produce a reasonable opportunity to earn a fair return on investment. It is essential
183 to maintain a balanced approach that quantifies all elements of the revenue
184 requirement in an internally consistent manner. I would note that the AG-proposed
185 adjustment to utilize the average rate base approach that was used in this and in
186 previous PGL/NSG rate cases is a measurement convention, rather than any
187 disallowance of new rate base investments. The Companies' estimated plant
188 investments that are expected to be in service throughout the 2013 test year have
189 been measured at an average level, based upon estimated costs *without*
190 *disallowances*, so as to properly match the rate base with the corresponding
191 measurement period for operating revenues, operating expenses and the estimated
192 cost of capital.

193 **Q. If the new rates in these Dockets do not go into effect until July 2013, as**
194 **contended by Mr. Schott, will use of an average rate base deny recovery of**
195 **higher rate base investments that may exist by year-end 2013?**

196 A. No. If new rates are effective in July, based upon an average rate base for 2013,
197 the Company will immediately commence recovery of a return on investment for
198 the amounts of estimated rate base investments that are in place at that date, since
199 July is near the mid-point of calendar year 2013. This is entirely appropriate

because the test year estimated expense and revenue levels at this mid-point of the calendar year should also be reasonably synchronized with the newly implemented rates. The fallacy with Mr. Schott's argument is the supposition that use of a forecasted test year somehow entitles the Companies to an expectation of zero regulatory lag throughout and after the 2013 test year.

Q. If the new rates in these Dockets do not go into effect until July 2013, would utilization of a year-end rate base, as proposed by the Companies, produce an unreasonable result?

A. Yes. Using a forecasted year-end rate base would cause the new rates effective in July of 2013 to be overstated, because such rates would include a return on rate base plant assets that do not yet exist at that time. In particular, the forecasted plant investments expected by the Companies to be added in the last half of 2013 that exceed average projected rate base levels, would represent non-existent Plant as of July that are not being used in the provision of public utility services as of July of 2013.

Q. In his Rebuttal, Mr. Schott states, "Staff witness Mr. Kahle acknowledges that the Utilities are increasing their levels of capital spending, although he seeks to dismiss that fact on the grounds that it is 'normal for the Companies to have increased investments after filing a rate case' and that an average rate base was used in their previous future test year rate cases. He does not otherwise address the point that this fact means that the rates being set will not reflect higher levels of investment after 2013." Are the expected higher levels of investment by the Utilities after 2013 a valid consideration in the pending rate cases?

224 A. No. As I explained in my Direct Testimony, all the elements of the Companies’
225 revenue requirement are dynamic throughout the passage of time. After 2013, we
226 can reasonably assume that PGL’s gross investment level in new plant will continue
227 to grow, as emphasized by Mr. Schott. However, after 2013, the Companies’
228 continuing accruals of depreciation expense will produce higher accumulated
229 depreciation reserve balances that reduce rate base. After 2013, the full annual
230 impact of long term debt refinancing activities will be recorded as reduced interest
231 expense. After 2013, continuing changes in gas sales volumes, employee staffing
232 levels, wage rates, revised actuarially determined pension expenses, expense savings
233 from new technologies or efficiency gains would all impact the Companies’ revenue
234 requirements. My understanding of recently enacted income tax legislation is that
235 bonus tax depreciation has now been extended through 2013⁸ and this will
236 contribute to rapidly growing accumulated deferred income tax balances that reduce
237 rate base. Finally, some of the investments in new plant for the PGL Accelerated
238 Main Replacement Program are expected to produce significant expense savings
239 that should be captured in future rate case test years, but are not reflected in 2013
240 test year expenses.⁹

241 It is essential to recognize that test year ratemaking requires carefully
242 balanced consideration of all the changing elements of the revenue requirement,
243 without singling out specific items trending in a direction favorable to a particular

⁸ Section 331 of the American Taxpayer Relief Act of 2012 extends Section 168(k) of the Internal Revenue Code provision for bonus depreciation through calendar 2013. Bonus depreciation authority was previously scheduled to expire on January 1, 2013.

⁹ In response to Data Request AG 16.02b, PGL stated, “The forecasted level of operating expenses in Peoples Gas’ revenue requirement reflects, among other things, the forecasted plant in service. The budgeting and forecasting processes do not include a specific analysis of how operating expenses have been and will be affected by the acceleration of main replacement in particular. Such an analysis is not part of the normal budgeting and forecasting processes and is not required.”

244 advocate. It is understandable why the Utilities' would seek to focus the attention
245 of regulators upon only new plant investment that is expected to significantly
246 increase in the future, so as to rationalize PGL's and NSG's proposed mismatching
247 of the rate base, cost of capital and operating income determinants of the revenue
248 requirement to the advantage of shareholders. However, this mismatching is
249 inappropriate and is not consistent with traditional test year ratemaking principles
250 normally applied in Illinois and in other states.

251 **Q. Is there any indication that "Peoples Gas cannot afford to keep investing in**
252 **accelerated main replacement" if an average rate base is used, as suggested by**
253 **Mr. Schott?**¹⁰

254 A. No. The Companies have offered no evidence that use of a forecasted test year with
255 an average rate base will cause any deterioration in credit ratings or reduce the
256 Companies' access to capital on reasonable terms. Mr. Schott's testimony instead
257 indicates a "reduced willingness" to invest. In response to Data Request AG 16.01a,
258 PGL stated, "Mr. Schott's testimony speaks for itself. That being said, Mr. Schott's
259 testimony indicates a reduced willingness by management to invest in accelerated
260 main replacement in the circumstances of the reductions in recovery of the costs of
261 such projects proposed by Staff, the AG, and CUB-City." The same response
262 clarifies that public safety will not be jeopardized by any reduced discretionary
263 investments made by PGL if traditional average rate base calculations are used in
264 the forecasted test year, by indicating, "The Utilities maintain a safe and reliable
265 system. They have never claimed that accelerated main replacement is necessary to

¹⁰ *Id.* at p. 6, line 102

avoid significant reductions in safety and reliability.” I have included a copy of this response within AG Exhibit 4.3.

Q. Does Company witness Hengtgen acknowledge that a future test year, as employed by the Utilities, would typically be based upon a simple average of the rate base amounts at December 31, 2012 and December 31, 2013, as reflected in the AG-proposed revenue requirement calculation?

A. Yes. Mr. Hentgen states at page 8 of his Rebuttal that, “First, I agree that the test year chosen by the Utilities is future in nature and is for calendar year 2013. I also agree that the proposal of an average rate base would typically be a simple average of the rate base amounts at December 31, 2012, and December 31, 2013.”

Q. Does Mr. Hengtgen recognize any difference in the regulatory lag that arises from using a future test year as compared to an historical test year?

A. Not in the testimony that he sponsors. For instance, he fails to note that with an historical test year, the utility must first make the capital investments in new utility plant and then seek recovery only after the investments have been made. This entails considerably more regulatory lag than a future test year, where new utility rates are set based upon estimates of future capital spending. Under these circumstances, when relying on *historical* test year data, this Commission and many others around the country routinely allow use of a year-end rate base, with annualized revenue and cost adjustments at year-end, in an effort to reduce the regulatory lag arising from ratemaking that requires actual spending prior to rate recovery.

288 **Q. Simply because a year-end rate base has been used in Illinois with historical**
289 **test years, should year-end rate base calculations also be used with a future test**
290 **year?**

291 A. No. Mr. Hengtgen claims in his Rebuttal, “It is my understanding that historically,
292 when an historical test year is used, the Commission has approved a year end rate
293 base. The matching principal as formulated by Staff and these intervenors is not
294 applied in those situations to require an average rate base. That makes sense because
295 the rates being set go into effect sometime after the historical test year. That also
296 makes sense if the utility’s investment is increasing.” What Mr. Hengtgen fails to
297 recognize is that the vast reduction in regulatory lag that occurs when using a future
298 test year eliminates any need to modify the matching principle to the year-end rate
299 base approach that is often employed when using an historical test year.

300

301 **III. FORECASTED LABOR EXPENSES.**

302 **Q. Has the Company accepted the adjustment you proposed to account for**
303 **average levels of vacant employee positions?**

304 A. No. Rebuttal witness Mr. Hoops says he does not agree with the vacancy
305 adjustment I applied to the Companies’ labor cost forecasts. Mr. Hoops offers
306 several arguments in opposition to the AG’s adjustment to recognize average
307 employee vacancies in setting rates:

- 308
 - The employee count at any given moment is a snap shot in time that does not
309 reflect existing and future additions to employee count.

- Peoples Gas is currently filling a number of positions as described in my initial testimony as part of improved compliance with federal and state pipeline safety regulations and the accelerated main replacement project.
- Utility Worker positions are being filled from the school created by Peoples Gas in partnership with the City Colleges of Chicago and the UWUA Power for America Training Trust Fund at the Dawson Technical Institute in Chicago.
- North Shore is literally two positions below its budgeted headcount as of November 24, 2012 and is in the process of hiring for both of those positions.
- With the additions indicated above, the Utilities' employee headcount will be equivalent to the employee headcount reflected in the filed test year operations and maintenance expense.¹¹

I will respond to each of these arguments and explain why the employee vacancy adjustment remains appropriate and reasonable for application to the Companies' labor expense forecasts for the test year.

Q. Is it true that the “employee count at any given moment is a snap shot in time that does not reflect existing and future additions to employee count” as asserted by Mr. Hoops?

A. Yes. Actual employee counts and vacancy statistics “at any given moment” are different from projected future staffing statistics. However, the adjustment to account for employee vacancies that I proposed is not based upon any “snapshot” or employee counts “at a given moment”. The adjustment I propose is instead based

¹¹ NS-PGL Ex. 28.0, pages 13 and 14.

upon the average level of employee vacancies that existed throughout the first nine months of 2012, comparing the actual number of filled positions in each month to the corresponding levels of planned and authorized positions.

Q. Does Mr. Hoops' assertion that "Peoples Gas is currently filling a number of positions" mean that the Company will experience no vacant employee positions throughout the 2013 test year?

A. Of course not. All large businesses experience unavoidable and fairly continuous turnover of staffing that should be considered in the development of expense forecasts. This fact is acknowledged by Rebuttal witness Ms. Gregor where she argues that the Companies' productivity should not be assumed to be increasing because, "...as seasoned employees retire and are replaced with new employees, the productivity would be more likely to stay the same or decrease slightly until those employees have gained experience."¹² The employee turnover that Ms. Gregor acknowledges exists is the reason an employee vacancy factor adjustment is appropriate. No business can fully and precisely anticipate the timing of employee retirements and terminations and then have replacement staffing hired and ready to immediately start employment the following day, as is assumed in the Companies' test year labor expense forecasts. In fact, it is not uncommon for vacant positions to remain unfilled for many weeks or months, either intentionally as a cost control measure or simply because of the significant amount of time required to post or advertise the vacant position, recruit and interview candidates, administer qualifications testing, make selections and offers and finalize employment arrangements to establish start dates for new employees.

¹² NS-PGL Ex. 25.0, page 6, line 123.

356 **Q. Does it matter that, “Utility Worker positions are being filled from the school**
357 **created by Peoples Gas,” as indicated by Mr. Hoops?**

358 A. Not really. The recruitment, hiring and training of new employees is a continuous
359 process because of the fact that employee vacancies and turnover are inevitable.
360 The need to create a “school” to train and hire new employees is indicative of the
361 challenges associated with attracting and retaining qualified staff even in periods of
362 relatively high unemployment. To state the obvious, it is highly unlikely that all of
363 the new employees hired by PGL to increase staff counts to test year targeted levels,
364 along with the entire complement of existing employees, will experience no
365 turnover or attrition for a multitude of reasons that routinely cause the termination
366 of existing employees in the normal course of business.

367 **Q. What is the significance of Mr. Hoops’ assertion that, “North Shore is literally**
368 **two positions below its budgeted headcount as of November 24, 2012 and is in**
369 **the process of hiring for both of those positions.”?**

370 A. This appears to be one of the “snap shot in time” measures that Mr. Hoops
371 separately argues should not be relied upon to conclude anything about employee
372 levels or vacancy rates. North Shore can expect to experience unplanned vacancies
373 from time to time throughout test year 2013. No employee vacancies have been
374 assumed or accounted for in the Company’s test year labor expense forecast and this
375 is a problem that should be addressed to avoid charging customers for salaries and
376 benefits of employees that, from time to time, do not exist. Neither the brief
377 achievement of full staffing if North Shore succeeds in filling two presently vacant
378 positions nor a lack of terminations over a brief period of time is relevant given the

379 reality of normal, recurring turnover that is inevitable in any large business
380 enterprise.

381 **Q. How many vacant positions at North Shore Gas are implied by the 2.7 percent**
382 **average vacancy rate applied to overall labor expenses in the AG's adjustment**
383 **at AG Exhibit 4.2, Schedule C-2, line 10?**

384 A. Test year projected NSG staff levels total 171 positions, so the AG-proposed 2.7
385 percent vacancy rate implicitly assumes that only 4.6 positions are vacant on
386 average throughout the test year.¹³ It is entirely possible for a utility to accelerate
387 hiring efforts in an effort to temporarily "prove up" forecasted rate case staffing
388 levels, but the reality of some structural level of vacancies should not be ignored in
389 estimating labor expenses in a forecasted test year.

390 **Q. Mr. Hoops states, "With the additions indicated above, the Utilities' employee**
391 **headcount will be equivalent to the employee headcount reflected in the filed**
392 **test year operations and maintenance expense." If the planned new hires start**
393 **work in 2013, does it follow that the Companies will experience no employee**
394 **vacancies throughout the rest of the test year?**

395 A. No. There is no practical way for a large public utility to avoid a normal, ongoing
396 level of authorized but vacant employee positions. The Companies may complete
397 all the planned new hires that are discussed in Mr. Hoops rebuttal testimony, but it
398 will prove impossible for PGL and NSG to avoid the employee retirements,
399 resignations, deaths, disabilities and terminations for cause that routinely occur
400 within any large labor force.

¹³ PGL responses to AG 1.03 indicates forecasted full time equivalent employee counts of 170.68 positions in each month of the forecasted 2013 test year.

401 **Q. Mr. Hoops seems to disparage the adjustment your propose, stating, “Mr.**
402 **Brosch is recommending that the Utilities’ 2013 test year payroll expense be**
403 **reduced to reflect what he calls an average vacancy factor. “ Are you familiar**
404 **with another regulatory jurisdiction that routinely applies a “vacancy factor”**
405 **to test year projected headcounts and labor-related expenses?**

406 A. Yes. Utilitech has participated in all the major electric utility rate case proceedings
407 in Hawaii since the early 1990s and has successfully advocated for application of
408 estimated employee vacancy factors to reduce the forecasted labor and benefit
409 expenses asserted by the Hawaiian Electric Companies¹⁴ in many of those cases.
410 The following recent Hawaiian Electric Companies’ rate cases were settled with
411 Commission approval adopting and applying the labor vacancy rates shown below
412 to forecasted test year labor and benefits expenses:

413 **TABLE 2: EMPLOYEE VACANCY FACTORS IN HAWAII RATE CASE FORECASTS**

Utility	Docket No.	Future Test Year	Stipulated Vacancy Percentage
Maui Electric Co.	2011-0092	2012	3.46%
Hawaiian Electric Co	2010-0080	2011	4.44%
Maui Electric Co.	2009-0163	2010	3.0%
Hawaii Electric Light	2009-0164	2010	7.31%
Hawaiian Electric Co	2008-0083	2009	2.68%

414
415 **Q. Has any witness for the Companies challenged the mechanical calculations**
416 **associated with the AG vacancy rate adjustments?**

417 A. Yes. The Rebuttal Testimony of Companies’ witness Ms. Christine Phillips
418 addresses the inclusion of employee benefit costs within the AG vacancy rate

¹⁴ The Hawaiian Electric Companies include Hawaiian Electric Company, which serves the island of Oahu and is the parent company of Hawaii Electric Light Company serving Hawaii island and Maui Electric Company, Limited, serving the islands of Maui, Lanai and Molokai.

adjustment. She claims that, “The total employee benefit costs include some items that would not be relevant for new hires, which is presumed when talking about vacancies. The largest of such items is pension cost (\$30.0 million for Peoples Gas and \$3.6 million for North Shore) and post-retirement welfare (\$12.2 million for Peoples Gas and \$1.9 million for North Shore). Any adjustment to benefit costs for “vacancies” should not be including these items in the calculation. The pension plan is closed to new entrants and there is a one-year lag before any new hires would be picked up in the information used by the outside actuary to calculate the post-retirement welfare costs.”

Q. Is Mr. Phillips correct when she “presumes” that the AG vacancy rate adjustment pertains only to new hires?

A. No. The AG vacancy rate adjustment is applied to total projected employee labor expenses associated with all employees and is not limited to only new hires as presumed by Ms. Phillips. Existing employee positions are just as likely to become vacant in the future as any newly created and filled positions. However, in order to recognize that pension and post-retirement welfare costs are driven largely by actuarial assumptions rather than the number of participant employees, I have modified the AG vacancy rate adjustment to exclude these benefit costs. This should not be viewed as acceptance by the AG of any assumption that employee vacancies relate only to newly created positions, as presumed by Ms. Phillips, but instead to add conservatism to the AG vacancy rate adjustment and to remedy the only perceived mechanical infirmity in the vacancy rate adjustment that was addressed in the Companies’ Rebuttal.

442 **Q. Have you changed the AG vacancy rate adjustment calculations at Schedule C-**
443 **2 of AG Exhibits 4.1 and 4.2?**

444 A. Yes. I have now reduced the “Employee Benefits to Expense in 2013 Test Year”
445 input amount on Schedule C-2 to exclude the embedded pension and post-retirement
446 welfare expenses, as stated at Schedule C-11.3 of the Companies’ filings. The
447 effect of this reduction is to leave the Companies’ test year projected expenses for
448 these elements of employee benefits unadjusted for estimated employee vacancies.¹⁵

449 **Q. At AG Exhibits 1.3 and 1.4, Schedule C-3, you proposed a wage rate increase**
450 **correction adjustment. Have the Companies addressed in Rebuttal Testimony**
451 **the incorrect wage rate increase assumptions that lead to overstated payroll**
452 **expense estimates in their Direct Testimony?**

453 A. Yes. Ms. Moy has sponsored downward expense adjustments in her Rebuttal
454 Testimony to “update the non-union wage increase for test year 2013 from 3.85% to
455 3.45% as indicated in the response to Staff data request JMO 16.03.”¹⁶ Since these
456 adjustments have been included in the Companies’ asserted Rebuttal revenue
457 requirement, which is the starting point for Exhibits AG 4.1 and 4.3, the adjustments
458 previously appearing at Schedule C-3 in both AG Exhibits 1.3 and 1.4 are no longer
459 required, and have been eliminated.

460
461
462 **IV. PRODUCTIVITY FORECAST ASSUMPTIONS.**
463

¹⁵ The breakdown of PGL, NSG and IBS-allocated Employee Benefits is found at NS-PGL Ex. 31.1P and 31.1N, respectively.

¹⁶ NS-PGL Ex. 26.0, page 13, line 269.

464 **Q. In your Direct Testimony and in AG Exhibits 1.3 and 1.4 you explained and**
465 **quantified a modest 0.5% annual productivity offset to the inflation and wage**
466 **rate assumptions used to develop the Company's forecasted expenses. How**
467 **have the Companies responded to your productivity adjustment?**

468 A. At page 6 of her Rebuttal Testimony, Ms. Gregor offers several reasons why she
469 believes that the modest AG-proposed productivity offset should be rejected. These
470 include her arguments that:

- 471 • Mr. Brosch has given no support for the percentage proposed;
- 472 • Mr. Brosch does not take into account that the workload for PGL and NSG
473 is increasing;
- 474 • as seasoned employees retire and are replaced with new employees, the
475 productivity would be more likely to stay the same or decrease slightly until
476 those employees have gained additional experience.
- 477 • the Utilities' budgets and forecasts reflect the overall labor and other non-
478 fuel O&M costs that are expected, based on past experience and other
479 available information. Thus, changes in productivity inherently are taken
480 account and are not and do not need to be broken out as a separate factor,
481 which would be redundant.
- 482 • The productivity adjustment is a subjective adjustment.

483 Beyond these stated conceptual disagreements with the AG's productivity
484 adjustment, Ms. Gregor also asserts that the adjustment is not correctly quantified
485 because the adjustment, "... includes benefit costs, injuries and damages, insurance
486 expense and material costs for which a productivity adjustment is not applicable."
487 According to Ms. Gregor's Rebuttal, "Eliminating these costs would lower his

adjustment by \$741,000 for Peoples Gas and \$101,000 for North Shore, setting aside that no adjustment is correct. *See* NS-PGL Ex.25.6N and NS-PGL Ex. 25.6P.¹⁷

Q. Is it correct that the ½ percent per year productivity offset you propose is subjectively determined and that you have provided no support for these amounts?

A. No. I explained in my Direct Testimony instances where productivity offsets have been imposed in California and New York within forecasted test year environments. It is not necessary to conduct specific studies of the historically achieved levels of actual productivity for PGL or NSG because the Companies' should be expected to strive for and achieve broader productivity performance targets that have been found to be applicable to other utilities in the industry, rather than simply accepting as reasonable PGL's and NSG past productivity performance levels. As a further example, earlier in this testimony I mentioned Utilitech's work in Hawaii, which is another state that has applied productivity offsets to projected O&M expenses. Approved rates for the Hawaiian Electric Companies are subject to annual adjustment pursuant to a Rate Adjustment Mechanism ("RAM") between triennial traditional rate cases. In calculating RAM rate adjustments, utility O&M labor costs are escalated for contractual union wage increase percentages that are then reduced by an annual 0.76 percent productivity offset and non-labor expenses are escalated using an inflation factor that is net of economy-wide productivity effects.¹⁸

¹⁷ NS-PGL Ex. 25.0, page 6, lines 119-137.

¹⁸ A copy of the Rate Adjustment Mechanism tariff of Hawaiian Electric is available at: <http://www.heco.com/vcmcontent/StaticFiles/FileScan/PDF/EnergyServices/Tariffs/HECO/HECORatesRAM.pdf>

509 **Q. Have the Companies presented in Rebuttal any evidence regarding a**
510 **productivity trend or measure that has been applied in development of their**
511 **forecasted test year expense levels?**

512 A. No. Instead of quantifying or explicitly addressing where or how productivity
513 changes have been handled in development of test year expense forecasts, Ms.
514 Gregor has stated in response to Data Request AG 16.09a that, “There is not an
515 exact dollar amount and/or percentage of productivity gains that was reflected with
516 the test year forecasts, but productivity inherently is taken into account in the
517 forecasts.” Ms. Gregor, however, fails to elaborate on that point. A complete copy
518 of PGL’s response to Data Request AG 16.09 is included as AG Exhibit 4.4.¹⁹

519 **Q. Why should the Companies be able to specifically identify and quantify**
520 **productivity gain assumptions if they were part of the test year forecasting**
521 **process?**

522 A. If any specific level of productivity gain was assumed or targeted in developing the
523 Companies’ test year expense forecasts, one would reasonably expect the assumed
524 level of such productivity improvement to be stated as a forecasting assumption or
525 identified as a specifically predicted test year cost savings element, similar to
526 projected wage increase rates or other measureable adjustments. However, a close
527 examination of the Companies’ budgeting assumptions stated in Part 285.7025,
528 Schedule G-5, Section III Operations and Maintenance Costs reveals that no stated
529 productivity assumptions were made to offset the assumed wage increase rates and
530 that default assumed annual inflation rates were applied for 2012 and 2013 without

¹⁹ Copies of data requests are included in AG Exhibits where a substantive response was provided, omitting the corresponding North Shore Gas response which typically states, “See Peoples Gas’ response” to the same question.

any reduction for productivity effects. As I described in my Direct Testimony²⁰, the Company's labor forecasts were instead driven by the Companies' judgments regarding levels of work to be performed in 2013 and estimates of numbers of employees required to be added to perform this work, then escalating salary levels to account for expected wage increases to be effective within 2013. For non-labor expenses, forecasts were prepared specifically estimating certain costs, but with broadly applied general inflation indexing for most non-gas expenses that are not labor-related.²¹

Q. If past levels of productivity improvement are embedded within PGL and NSG historical actual staffing and expense levels, why should we not assume that such embedded productivity is “inherently” reflected in the Companies’ 2013 test year forecasts proposed for ratemaking purposes?

A. Historical levels of productivity, if rolled forward with labor and non-labor escalation factors as described in the Companies’ Schedule G-5, will assume no incremental improvement in productivity. In this case, the Commission is asked to accept that utility management has achieved sufficient productivity gains historically and should not be expected to achieve incremental improvements in productivity in the just-completed 2012 calendar year and within the 2013 test year. The AG-proposed adjustment would impose a regulatory expectation that management can and should achieve incremental productivity improvements that will serve to offset the effects of inflation and wage rate increases.

²⁰ See AG Exhibit 1.0, page 15, lines 309-343 and page 20, lines 429-439.

²¹ *Id.* at p. 22, lines 469-484.

552 **Q. Do you agree with Ms. Gregor’s view that increasing levels of workload at PGL**
553 **and NSG suggest that any expectations for productivity improvement should**
554 **be diminished?**

555 A. No. If more work must be done, there is no reason it should not be done with
556 increasing attention to efficiency and productivity. In PGL’s response to Data
557 Request No. AG 16.10, the Company concedes that, “Ms. Gregor does not believe
558 that productivity improvements cannot occur when workload is increasing.” I have
559 included a copy of this data request response as AG Exhibit 4.4.

560 **Q. Is Ms. Gregor’s claim that, “...as seasoned employees retire and are replaced**
561 **with new employees, the productivity would be more likely to stay the same or**
562 **decrease slightly until those employees have gained additional experience”²²**
563 **reasonable?**

565 A. No. As I explained previously in this testimony, turnover within the utility
566 workforce is routine and expected. In fact, the turnover acknowledged by Ms.
567 Gregor is the reason why the AG’s employee vacancy rate adjustment is necessary.
568 In spite of normal, recurring turnover in the workforce, utilities can and do achieve
569 productivity gains through time. On this point, Ms. Gregor’s Rebuttal is not
570 internally consistent where she argues that test year productivity improvements have
571 been “inherently considered” in developing test year forecasts at the same time she
572 asserts that employee turnover causes productivity to “stay the same or decrease
573 slightly.” In response to Data Request AG 16.11 and AG 16.11 Supplement, the
574 Companies stated, “Ms. Gregor did not conclude that firms that experience turnover

²² NS-PGL Ex. 25.0, page 6, line 123.

575 of seasoned employees cannot achieve improved productivity.” A complete copy of
576 this response is included within AG Exhibit 4.4.

577 **Q. Does Ms. Gregor know with certainty that any productivity gains have been**
578 **taken into account in the Companies’ test year forecasts?**

579 A. According to the Companies’ response to Data Request AG 16.12, she does not. A
580 complete copy of this response is included within AG Exhibit 4.4.

581 **Q. Ms. Gregor has criticized the AG productivity adjustment as being unduly**
582 **“subjective.”²³ Do some elements of the Companies’ own rate case test year**
583 **forecasts of O&M expense and rate base involve subjective judgments?**

584 A. Yes. The subjective nature of expense forecasting within the 2013 test year is
585 described in the Companies’ response to Data Request No.AG 16.13. A complete
586 copy of this response is also included within AG Exhibit 4.4. My proposed
587 productivity adjustment is no less subjective than some of the assumptions
588 employed in the Companies’ test year forecasting.

589 **Q. Ms. Gregor has also suggested that certain categories of O&M expense should**
590 **be excluded from application of the AG-proposed productivity offset**
591 **adjustment.²⁴ Do you agree with these revisions?**

592 A. I agree that it is reasonable to remove injuries and damages, insurance and postage
593 costs because these expense elements are largely, but not completely, beyond the
594 control of management and, therefore, it is far more difficult to achieve productivity
595 gains reducing these costs than in other expense categories. With respect to the
596 benefits cost area, for the reasons stated above I would also agree to remove
597 pension and post-employment benefit costs from application of the productivity

²³ *Id.* at line 129.

²⁴ *Id.* at p. 7. *See also* NS-PGL Ex. 25.6N and 25.6P.

offset. However, for material costs and for the other elements of employee benefits, gains in management efficiency should gradually enable the performance of more work with reduced labor hours and other non-labor input resources over time.

Q. Have you revised AG Exhibits 4.1 and 4.2 at Schedule C-4 to refine the scope of the AG's productivity adjustment?

A. Yes. The line 1 Company Proposed Adjusted O&M Expense amount has been revised to conform to the higher expense levels now being proposed in the Companies' Rebuttal filings, instead of their Direct Testimonies. Then, additional and revised subtractions are made to the Companies' proposed O&M at lines 3 through 11 to tie in expense disallowances made elsewhere in the AG revenue requirement calculations and to exclude the expenses for pension, post-retirement benefits, injuries and damages, insurance and postage, as described above.

V. INCENTIVE COMPENSATION.

Q. How have the Companies responded to proposed disallowances of Incentive Compensation expense that was proposed in your Direct Testimony and in the testimony of Staff and CUB/City of Chicago witnesses?

A. Companies' witness Ms. Noreen Cleary states, starting at page 2 of her Rebuttal Testimony, that the Companies will not contest the disallowances proposed for the Executive Incentive Compensation Plan and the Omnibus Incentive Compensation (equity/stock) Plan.²⁵ However, the partial disallowances I proposed for the

²⁵ Ms. Cleary's Rebuttal indicates, at line 22 and 41, a desire to "reserve the right to contest similar disallowances sought in future rate cases or other proceedings."

620 Companies' Non-executive Incentive Compensation Plan are contested by Ms.
621 Cleary.

622 **Q. Have the Companies made reductions to their asserted revenue requirements**
623 **in Rebuttal to incorporate the non-contested disallowances of the Executive**
624 **and Omnibus stock-based incentive compensation plans?**

625 A. Yes. Adjustments have been included to reduce test year expenses and annual test
626 year depreciation on prior years' capitalized incentive compensation costs
627 associated with these two plans within NS-PGL Ex. 26.1N and 26.1, as described in
628 Ms. Cleary's Rebuttal Testimony.

629 **Q. What incentive compensation expense remains in dispute, after consideration**
630 **is given to changes made by the Companies in rebuttal testimony?**

631 A. The proposed 50 percent disallowance of the Non-executive Incentive
632 Compensation Plan that is recommended by CUB/City of Chicago witness Mr.
633 Smith and by me is contested by the Companies.

634 **Q. How do the disallowances of incentive compensation expense that the**
635 **Companies have elected to not contest impact the AG adjustment to incentive**
636 **compensation expenses in AG Exhibits 4.1 and 4.2 at Schedule C-5?**

637 A. It is necessary to narrow the scope of the AG-proposed adjustments to incentive
638 compensation, so as to recognize the incentive compensation expense reductions
639 that have now been made to the Companies' asserted revenue requirement in
640 rebuttal. Since the Omnibus stock-based incentive expenses have now been
641 complete removed by the Companies in rebuttal, I have deleted the adjustment
642 amounts appearing in column D of Schedules C-5. Similarly, because the
643 Companies have now removed expenses for the Executive Annual Incentive Plan,

the amounts in column B of Schedules C-5 have been reduced to include only the remaining Non-executive Plan costs the Companies continue to include in the asserted revenue requirement. After revising Column B to include only the Non-Executive Plan expenses, I recommend the same 50 percent disallowance that was explained in my Direct Testimony.

Q. How does Ms. Cleary respond to your assertion that the Utilities have not shown, in their forecasted level of O&M expenses, any assumed cost control benefits arising from the non-executive incentive plan cost-control metrics?

A. Ms. Cleary does not directly respond to my assertion, but instead states, “Much of Mr. Brosch’s argument is based on the fact that the Utilities’ rate cases are based on a future test year, and thus forecasted expense amounts rather than actual expense levels used in the incentive plans are used for ratemaking purposes. The Commission rules allow for the use of a future test year (*see* 83 Ill. Admin. Code § 287.20(b)), however, which necessarily require the use of forecasted rather than actual expense levels. In essence, therefore, Mr. Brosch’s argument is against the use of a future test year for determining incentive compensation costs, an argument that must be rejected because it is contrary to the Commission’s rules.”²⁶

Q. Does any Commission rule preclude consideration by the Companies of expected expense savings arising from employees’ responding to incentive compensation plans when developing test year expense forecasts?

A. No. It is my understanding that a utility’s forecast used in a future test year should be just and reasonable and reflective of the expenses required to operate and maintain the utility prudently. If incentive compensation plans are believed by the

²⁶ Companies responses to data requests AG 7.18 and AG 7.36 for NSG and PGL, respectively.

667 Companies to be effective and incrementally reducing expenses in each year that
668 such incentives are paid, both the cost of the incentives and the benefits produced
669 by the plan, i.e. the corresponding expense savings, must be included within test
670 year forecasts.

671 **Q. Is your argument “against the use of a future test year” as suggested by Ms.**
672 **Cleary?**

673 A. No. I simply recommend that if incentive compensation costs are being allowed
674 based upon the premise that cost-control metrics within the incentive plan are cost
675 effective, one of two outcomes should be required whenever a forecasted test year
676 is employed. Either the Companies should be able to demonstrate with specificity
677 that forecasted test year expenses have been directly reduced incrementally for the
678 expected amounts of future cost savings that will be induced by 2013 payments of
679 incentive compensation, or, alternatively, if such direct reductions for incentive plan
680 driven O&M savings have not been demonstrated to exist within the rate case
681 expense forecast, the Companies’ shareholders should bear the cost of the cost-
682 control portion of incentive compensation, because they alone will benefit when
683 and if such savings occur in 2013. Shareholders alone will benefit because the
684 relevant O&M savings are not reflected in rate case forecasted O&M.

685 **Q. How does Ms. Cleary attempt to rationalize the fact that forecasted 2013 test**
686 **year O&M expenses have not been reduced for assumed incremental cost**
687 **controls caused by 2013 incentive compensation payouts?**

688 A. At page 13 of her rebuttal, Ms. Cleary refers to a 2005 *ComEd* rate case where the
689 Commission is said to have concluded, “...that expenses for incentive
690 compensation metrics that encourage O&M cost control benefit customers because

691 ‘[l]owering O&M expenses, all else being equal, has the obvious effect of reducing
692 the expenses to be recovered in future rate cases’.” What is missing from this
693 analysis is an acknowledgment that in 2005 ComEd’s rates were being set based
694 upon historically incurred costs, which would automatically include any and all
695 experienced cost savings that were caused by the recorded amounts of incentive
696 compensation costs in the historical test year. In such an environment, ratepayers
697 are assured of participation in recorded expense savings resulting from cost-
698 effective incentive compensation plans that result in actual cost reductions.
699 Additionally, because ComEd’s expenses were not based upon a forecast, there was
700 no need to verify that incentive plan-driven expense savings were not being ignored
701 in developing the forecast.

702 The instant case is quite different from the ComEd case because a
703 forecasted test year is being employed. The O&M amounts in the test year
704 forecasts of each utility are estimated, such that there is no assurance that any future
705 expense savings that may be realized because of incentive compensation-driven
706 cost controls will ever be shared with ratepayers. Utility management has every
707 incentive to pessimistically forecast its costs in the forecasted test year and then
708 keep for shareholders any actual expense savings that may later appear within
709 recorded financial results.

710 **Q. How does Ms. Cleary respond to your Direct Testimony regarding the**
711 **problems caused by combining the O&M metric for all of the Integrys utility**
712 **subsidiaries, rather than tailoring incentive plan payouts to specific savings**
713 **realized by PGL and NSG?**

714 A. She has not responded directly to this obvious problem in the scope of the non-
715 executive incentive plan expense metric, but instead simply observes in rebuttal
716 that, “....after the implementation of the O&M cost control metric, both Peoples
717 Gas and North Shore were able to lower their levels of Total Non-fuel O&M
718 Expense Adjusted below the goals set in the incentive plan for 2011, as well as
719 versus the previous year’s levels for such costs.” We are left to imagine that no
720 expense savings could have been achieved but for the existence of incentive
721 compensation with O&M performance measured on a total Integrys utility basis.
722 Presumably her point is that since cost reductions were believed to have been
723 achieved in 2011, the absence of utility-specific cost control metrics for the plan in
724 later years and in the 2013 test year cannot reasonably be challenged.

725 **Q. At page 14 of her Rebuttal, Ms Cleary offers revisions to the annual expense**
726 **savings percentages that would be required to pay for incentive compensation**
727 **plan costs, in relation to the AG’s proposed 0.5 percent annual productivity**
728 **offset. Do her revised calculations continue to support your recommended**
729 **productivity offset adjustment at Schedule C-4?**

730 A. Yes. In my Direct Testimony I indicated that annual expense savings of about 3%
731 of O&M should be expected each year to be sure that the O&M cost control metric
732 within the Companies’ incentive compensation plans does not cost more in
733 compensation to employees than the expense savings that are produced. Given the
734 Companies’ consent in rebuttal to disallow the Executive Incentive Plan costs, and
735 also assuming no expense reductions should be demanded by ratepayers for a plan
736 that it is now treated as shareholder funded, Ms. Cleary argues that only a 1.66%
737 expense savings should be required in test year O&M savings to pay for the

incentive compensation plan cost controls now being requested. I would note that the Companies have not demonstrated that any future test year expense savings expected to be caused by 2013 incentive payments have been forecasted, which is why O&M incentives should not be recovered from customers. With regard to the AG's proposed productivity offset of 0.5 percent per year, incentive plan-driven annual expense savings of 1.66% still represent more than three times the 0.5% productivity offset that is being recommended by the Attorney General in my testimony.

VI. STATE INCOME TAX RATE ISSUE.

Q. Have the Companies consented in their rebuttal to utilization of the liability method of tax normalization accounting for the change in State Income Tax rates that you proposed in Direct Testimony?²⁷

A. No. The Companies' rebuttal witness Mr. Stabile claims that such an adjustment is "not appropriate" and directs most of his rebuttal testimony on this subject to CUB/City witness Mr. Smith, while acknowledging that his testimony, "equally applies to Mr. Brosch's testimony."²⁸

Q. Is Mr. Stabile correct in stating that the adjustment proposed by you and by Mr. Smith, "distorts the cost of service for utility asset[sic] across its service life?"²⁹

²⁷ AG Ex. 1.0, page 40, line 907. The reference at page 40 to ASC 840 is incorrect and should cite Accounting Standards Codification 740, which was formerly referred to as Financial Accounting Standard 109 or "FAS 109".

²⁸ NS-PGL Ex. 30.0, page 3, lines 56-58 and page 5, lines 107-138.

²⁹ *Id.* at p. 7, lines 152-163.

759 A. No. There is no distortion caused by consistent utilization of the liability method of
760 accounting for deferred income taxes that is mandated under Generally Accepted
761 Accounting Principles and that was approved by the Commission for use by ComEd
762 and Ameren, as noted in my Direct Testimony. The illustration provided by Mr.
763 Stabile in NS-PGL Ex. 30.1 is unreasonably focused upon only a single year of
764 assumed capital additions, as if there is not a continuum of newly acquired or
765 constructed utility assets in every tax year and every potential rate case test year.
766 By focusing upon a single tax year, Mr. Stabile is able to argue that “Customers in
767 2013 would pay approximately \$2.1 million less for the use of those assets, as
768 compared to customers in 2014.”³⁰ The reality is that “customers in 2014” would
769 realize comparable deferred income tax expense savings due to the Companies’
770 expected acquisition and construction of new tax-deductible asset in 2014, and in
771 every year thereafter.

772 **Q. Is Mr. Stabile’s improper reliance upon a single vintage of asset additions**
773 **revealed in the testimony he offers to explain his exhibit NS-PGL Ex. 30.1?**

774 A. Yes. At lines 145-151 Mr. Stabile states, “The effect of Mr. Smith’s method and
775 adjustment for a tax repair is that it lowers cost of service for an estimated future
776 tax benefit in the initial year(s) an asset is in service, flowing through a benefit to
777 tax expense that is uncertain and that will actually be realized in a future period.
778 For that asset individually, this benefit will not be repeated, and there is a resulting
779 increase in the carrying cost of that asset in each subsequent year the asset is in
780 service.” [emphasis added] The actual impact of using the liability method of
781 accounting is to recognize in every year that income taxes being deferred on newly

³⁰ *Id.* at p. 7, line 156.

added assets should be quantified based upon the statutory tax rates that will be effective when such deferred taxes turn around and become currently payable. In the context of scheduled reductions in the Illinois State Income Tax rates, the deferral of taxes during period of higher tax rates that will actually be paid in distant future years when rates are lower represent very real and permanent income tax savings that should not be denied to ratepayers. The Companies' proposed use of ARAM accounting seeks to charge customers a higher deferred income tax expense today than is expected to actually be paid in the future, when book/tax timing differences originating today are scheduled to reverse.

Q. Aside from his potentially misleading selection of a single vintage year of asset additions in NS-PGL Ex. 30.1 to support higher deferred income tax charges to ratepayers, does Mr. Stabile offer a second argument to support his contention that the Companies' approach is more reasonable?

A. Yes. Mr. Stabile also refers to the lower accumulated deferred income tax balances that would exist using the GAAP liability method of deferred tax accounting and states, "In addition, while not modeled in my exhibit, customers in 2014 and beyond, will pay a higher carrying cost (higher return because of reduced deferred income tax balance) on the increase in rate base caused by paying out the flow-through tax expense to 2013 customers."³¹ However, this argument is also potentially misleading because the lower deferred income tax balances and incremental higher rate base under the AG/CUB (and ComEd and Ameren) methods represent an accounting for the fact that ratepayers have not been forced to pay excessive deferred income tax expenses if the Companies' proposed ARAM

³¹ *Id.* at line 160.

approach is rejected. The lower deferred tax balances and correspondingly larger future rate base amounts would simply and consistently account for the time value of money during the years the Companies are not receiving the larger tax deferral benefits Mr. Stabile would instead like to collect from customers under the ARAM method he supports.

Q. Is Mr. Stabile correct in characterizing the adjustment to deferred income taxes that is proposed by you and Mr. Smith a “flow-through adjustment”³²?

A. No. The adjustments proposed by Mr. Smith and me contemplate full normalization of book/tax timing differences. The contested issue involves how to properly calculate deferred state income tax expenses when tax deductions taken today, at relatively higher tax rates, have the effect of deferring the actual payment of State income taxes to future years where tax rates will be lower. A “flow-through” tax expense adjustment would be much larger and would provide no ratemaking deferred income tax expenses in connection with the Companies’ tax deductible plant repairs, accelerated depreciation or bonus depreciation. Such a “flow-through” approach would instead immediately “flow-through” these massive tax deferral benefits as a direct reduction to ratemaking income tax expense. This is not being proposed by Mr. Smith or by me and would not be permissible under well understood restrictions within the Internal Revenue Code or under FERC accounting rules that require full normalization.³³ Mr. Stabile’s “flow-through” characterization of the AG and CUB/City adjustments should be recognized for what it is: unfair and misleading. The AG and CUB/City proposed adjustments actually serve only to correct test year deferred tax expense calculations to account

³² *Id.* at lines 204, 231, and 278.

³³ *See* AG Exhibit 1.0, page 39, line 893.

for differences between current and future statutory tax rates, with no flowing through of the tax deferrals arising from annual additions to utility plant.

Q. At line 148, Mr. Stabile again refers to “flowing through a benefit to tax expense” which he characterizes as “uncertain and that will actually be realized in a future period.” Is there any uncertainty created by use of the liability method of income tax normalization accounting that you propose?

A. No. The deferred income tax expenses allowed for ratemaking purposes should be recorded at the income tax rates expected to be effective when book/tax timing differences reverse in future years under the liability method. If the legislature acts to again change income tax rates, a re-measurement of required deferred income taxes would again occur and adjustments to deferred income tax expense would result from the changed tax rates in future rate cases. The Companies should have no problem recovering income tax expenses that are recorded in future test years pursuant to GAAP and FERC accounting rules, even if the result is a higher revenue requirement in rate cases.

Q. Does Mr. Stabile concede in his Rebuttal that use of the liability method of deferred income tax accounting, as proposed by you and by Mr. Smith, is not a violation of any Federal income tax normalization rules?

A. Yes.³⁴ However, he then makes reference to the Companies’ preferred use of an ARAM procedure that was used decades ago and that would serve to delay ratepayer participation in the Companies’ tax deferral benefits. I will not repeat the reasons stated in my Direct Testimony to explain why ARAM is not applicable to

³⁴ NS-PGL Ex. 30.0, page 12, line 278.

scheduled future changes in State Income Tax Rates.³⁵ As I noted in my earlier testimony, all of the Illinois State and Federal Income Tax regulations, FERC and ICC accounting requirements and Generally Accepted Accounting Principles that apply to ComEd and Ameren apply equally to PGL and NSG, and the Commission has already addressed the proper method of income tax normalization accounting with regard to changing Illinois statutory income tax rates in the most recent ComEd and Ameren Illinois ratemaking orders.³⁶

Q. Do you agree with Mr. Stabile’s rebuttal testimony at line 384 stating, “Mr. Smith’s adjustment is based solely on plant related book to tax differences, and does not reflect non-plant book to tax differences?”

A. I expect that only the plant related book/tax timing differences will persist into the future tax years when State income tax rates are scheduled to decline, so any further adjustment responsive to this criticism is unlikely to be significant to the revenue requirement. I would note that the Companies’ have provided no alternative calculation of deferred income tax expense using the liability method of accounting that would provide quantification of the deferred tax amounts associated with “non-plant book to tax differences” that are mentioned by Mr. Stabile.

Q. Mr. Stabile also argues at line 386 that, “Mr. Smith’s adjustment does not provide for a reversal of rate effects that would have taken place in 2013, assuming the Utilities would have followed Mr. Smith’s proposed method of accounting for plant related activity in 2011-2012.” Is this a valid criticism?

³⁵ AG Ex. 1.0, pages 40-42.

³⁶ Final Order, Ameren Illinois Utilities Docket No. 12-0293, pp. 89-97.

Final Order, Commonwealth Edison Company Docket No. 12-0321, pp. 32-33.

871 A. No. The test year adjustment to deferred income tax expense is prospective in
872 nature and is associated with the estimated provision for deferred income taxes to
873 be recorded and collected from ratepayers in 2013. There is no proposed
874 retroactive applicability of the liability method of accounting under the AG's
875 recommendation. Therefore, it would be inappropriate to presume and account for
876 any "reversal of rate effects that would have taken place in 2013" to assume
877 retroactive changes in the method of accounting for deferred taxes recorded in 2011
878 and 2012. If the Commission approves the same liability method of accounting for
879 deferred income taxes for the Companies that is being used by ComEd and Ameren,
880 the Companies can transition to this method starting in the 2013 test year and seek
881 rate recovery of the resulting changes in deferred income tax expenses in any future
882 rate cases that are filed.

883 **Q. Have you prepared any updates or corrections to the State Tax Rate Deferred**
884 **Income Tax Savings adjustment appearing in AG Exhibits 4.1 and 4.2, at**
885 **Schedule C-10?**

886 A. Not at this time. The adjustments presented in my Direct Testimony should be
887 viewed as tentative, pending a needed update for the significant revisions that should
888 be made to all of the deferred income tax expense calculations for the test year as a
889 result of the recently enacted *American Taxpayer Relief Act*. Under prior tax law, the
890 Companies were not able to claim income tax deductions for bonus depreciation after
891 the 2012 tax year. The new law approved by Congress and signed by the President at
892 the beginning of 2013 extends 50 percent bonus depreciation for an additional tax
893 year, which coincides with the 2013 test year in these Dockets. Data Requests have
894 been submitted by the Staff and AG to determine how the recent tax law changes

895 should impact the Companies forecasted 2013 rate base and operating income
896 calculations.³⁷ In addition to these new tax law changes, Mr. Stabile has indicated in
897 his Rebuttal a need to “update” for “the tax accounting change related to the
898 determination of whether an expenditure is a capital asset or repairs and maintenance
899 expense for tax purposes.”³⁸ In response to AG 20.01(c), received after close of
900 business on January 15, 2013, the Companies indicated that they “will be updating all
901 appropriate calculations with respect to its bonus depreciation election in 2013 in
902 surrebuttal testimony.” I wish to reserve the right to update and revise Schedule C-10
903 as necessary when new information becomes available for this purpose.

904 **Q. What is the purpose of the new adjustment to rate base that appears at AG**
905 **Exhibits 4.1 and 4.2 in Schedule B-4?**

906 A. Schedule B-4 was previously used by Mr. Effron to recognize some disputed deferred
907 income tax amounts and is no longer needed for that purpose. Schedule B-4 now
908 serves to recognize the estimated average rate base impact of the reduced provision
909 for deferred income taxes due to State Income Tax rate changes shown on Schedule
910 C-10. I agree with Mr. Stabile’s concern that Mr. Smith and I have failed to record
911 the corresponding decrease in accumulated deferred income taxes on the balance
912 sheet that would serve to increase rate base and the revenue requirement.³⁹ The
913 adjustment that now appears in Schedule B-4 increases rate base to recognize the rate
914 base effects of using the liability method of income tax normalization accounting and
915 the Schedule C-10 income statement adjustment. To the extent the adjustment at

³⁷ Mr. Effron has included the estimated impact of bonus depreciation upon accumulated deferred income tax balances included in rate base at AG Exhibits 4.1, Schedule B-6 and 4.2, Schedule B-8.

³⁸ NS-PGL Ex. 30.0, page 17, line 408 to page 19, line 476.

³⁹ NS-PGL Ex. 30.0, page 16, lines 380-384.

Schedule C-10 is revised in the future, the Schedule B-4 rate base adjustment is derivative from Schedule C-10.

VII. INVESTED CAPITAL TAX.

Q. How did the Companies' witness respond in rebuttal to your proposed adjustment to Invested Capital tax expense?

A. Ms. Moy's rebuttal is very brief on this topic and does not respond to my Direct Testimony explaining why the Companies' calculation method for this tax results in an overstatement of the tax expense that is to be recorded in the 2013 test year.⁴⁰ Instead, Ms. Moy focuses solely upon the Companies' derivative adjustment that improperly assumes that test year Invested Capital Tax should be increased as a direct result of the rate change ordered in these Dockets. My Direct Testimony fully explained why no such derivative adjustment is appropriate and will not be repeated here.

The more substantive rebuttal on this issue is sponsored by Mr. Stabile. He claims that, "The Utilities have updated invested capital tax estimates to be consistent with the long term debt and equity in the rebuttal filing in this preceding." I submit that this is the precise reason why the Companies' proposed level of Invested Capital tax is overstated. As explained in my Direct Testimony, the test year 2013 recorded invested capital tax expense amount will be based upon calendar 2012 recorded capital balances, not the later test year amounts. The Companies' proposed method of calculation for this tax results in estimation of a tax amount that will actually be

⁴⁰ NS-PGL Ex. 26.0, page 10, lines 210 to 230.

939 recorded in accounting periods after the test year, amounts that are inconsistent with
940 the rest of the asserted 2013 test year revenue requirement.

941 **Q. How does Mr. Stabile propose to calculate the amount of test year Invested**
942 **Capital Tax expense?**

943 A. Mr. Stabile first provides a legal definition, stating, ““Taxable period” is defined as
944 each period which ends after the effective date of the Gas Revenue Tax Act and
945 which is covered by an annual report filed by the taxpayer with the Commission. 35
946 ILCS 615/1.”⁴¹ He then opines that, “Since the 2013 test year will ultimately be an
947 annual period that is the subject year of an annual report to the Commission, the
948 annual period for the invested capital tax is 2013.” Finally, Mr. Stabile argues that
949 Mr. Brosch and Mr. Smith, “...are using 2012 information to calculate their
950 adjustment” and concludes that, “They both indicate that the tax for 2013 is based
951 upon 2012 data, but neither provides any basis for that conclusion.”⁴²

952 **Q. If we first focus on the Companies’ proposed calculation of this tax, when will a**
953 **tax return be filed that includes financial data for an “annual period for the**
954 **invested capital tax” of 2013 as proposed by Mr. Stabile?**

955 A. A tax return containing calendar year 2013 financial data will not be filed until 2014.
956 As I noted in my Direct Testimony, the taxes calculated by PGL and NSG that are
957 based on estimated investment levels in 2013 would not be payable or expensed on the
958 books until *after* 2013. Thus, Mr. Stabile’s calculation approach actually yields an
959 estimated tax expense for the following tax year, calendar 2014. It is not reasonable
960 to include within a 2013 test year estimated invested capital expenses that are not
961 payable until 2014 and will not be recorded on the Companies’ books until 2014.

⁴¹ NS-PGL Ex. 30.0, page 34, line 818.

⁴² *Id.* at lines 833-838.

962 **Q. Is it correct that you have provided “no basis” for a conclusion that the tax for**
963 **2013 is based upon 2012 data, as asserted by Mr. Stabile?**

964 A. No. I very clearly stated in my Direct Testimony that, in response to data requests
965 AG 8.10 and 8.20, the Companies admitted that “The Illinois Invested Capital tax is
966 recorded on the books as a monthly accrual. The monthly accrual is based upon last
967 year’s tax divided by twelve (months).”⁴³ Because of this fact, the estimated tax
968 recorded for the 2013 test year will be based upon the financial data that will appear
969 on the tax return to be filed by March of 2013, which is in turn based upon beginning
970 and end-of-year 2012 invested capital balances. AG Exhibit 4.5 contains copies of
971 the Companies’ responses to Data Requests AG 8.10, 8.20, 10.13 and 10.28 which all
972 support the “basis” for the AG’s positions. These responses document how the
973 Companies account for Invested Capital Tax while revealing two obvious facts:

- 974 1. No complex calculations involving estimated capital balances at the
975 beginning and end of 2013 are needed to accurately determine the
976 Invested Capital tax that will be recorded on the Companies books in
977 2013, and,
- 978 2. The Companies’ further adjustment to “factor-up” the already overstated
979 estimate of 2013 tax amounts for “additional revenues” from the rate
980 increase, as described by Ms. Moy, simply adds to the overstatement of
981 calendar 2013 Invested Capital taxes.

982 The method of calculating the 2013 Invested Capital tax that is set forth in AG
983 Exhibit 4.1 and 4.2 at Schedule C-11 properly employs 2012 financial data to

⁴³ See AG Ex. 1.0 at 44.

984 calculate the estimated tax amount that will be expensed by the Companies on their
985 2013 accounting records.

986 **Q. Have you made any revisions to the AG's calculation of Invested Capital Tax?**

987 A. No. However, according to Mr. Stabile's rebuttal, "The Utilities have updated
988 invested capital tax estimates to be consistent with the long term debt and equity in
989 the rebuttal filing in this preceding."⁴⁴ Since AG Exhibits 4.1 and 4.2 use the
990 Companies' Rebuttal revenue requirement as a starting point, the "Company-
991 proposed Test Year Level of Invested Capital Tax" at line 10 of Schedule C-11 has
992 now been revised to reflect the Companies' updated position regarding such tax
993 amounts in rebuttal. No substantive changes have been made to the calculations I
994 employed to determine the "Annual Invested Capital Tax to Be Recorded and Paid
995 in 2013" at line 9 of Schedule C-11.

996

997 **VIII. CHICAGO DOT REGULATIONS & CROSS BORES.**

998

999 **Q. In your Direct Testimony, you explained the basis for an AG adjustment to**
1000 **remove PGL's estimated incremental costs of compliance associated with**
1001 **changes to the Chicago Department of Transportation ("CDOT") Regulations**
1002 **For Openings, Construction And Repair in the Public Way (new CDOT**
1003 **Regulations) dated July 2012. Has the Company provided additional**
1004 **information in connection with the added CDOT costs first asserted in the**
1005 **Supplemental Direct Testimony of Mr. Kyle Hoops that was filed on October**
1006 **23, 2012?**

⁴⁴ *Id.* at line 806.

1007 A. Additional information has now been provided in response to AG and CUB data
1008 requests to explain the basis for PGL's cost estimates while also highlighting some
1009 ongoing uncertainty with respect to how and when the new regulations will be
1010 interpreted and applied to PGL.

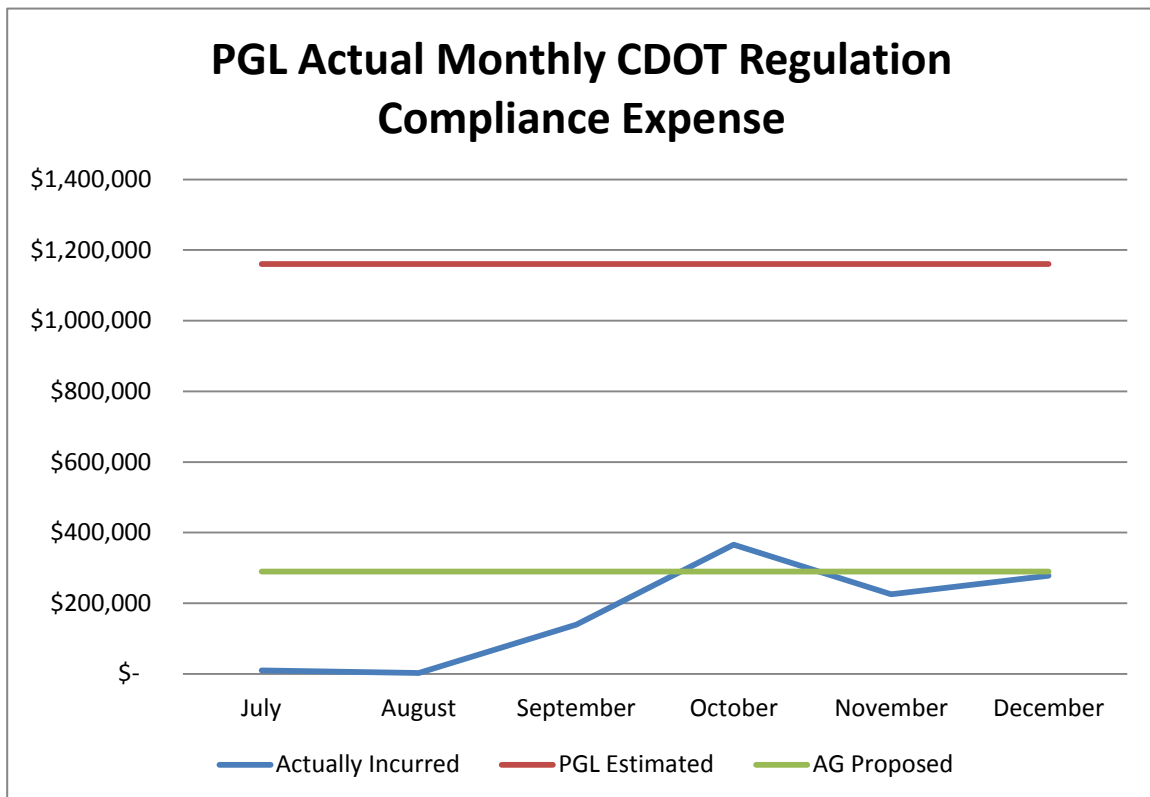
1011 **Q. Have you prepared a revised adjustment in connection with PGL's asserted**
1012 **incremental costs for compliance with the new CDOT regulations?**

1013 A. Yes. Noting that the regulations have now been in effect for about six months, I
1014 propose a revision to the estimate of compliance costs that was submitted in Mr.
1015 Hoops' Supplemental Testimony, as reflected in Revised AG Exhibit 4.1 at
1016 Schedule C-6. The expense allowance I propose is based upon cost levels actually
1017 being experienced by the Company to comply with the new CDOT regulations in
1018 the fourth quarter of 2012. Lines 2 through 4 of Schedule C-6 show the monthly
1019 actual recorded incremental maintenance expenses recorded by PGL in October,
1020 November and December of 2012 for compliance with the new regulations using
1021 the same expense categories used by Mr. Hoops to develop his test year estimated
1022 costs in his Supplemental Testimony. I propose a lower CDOT compliance expense
1023 allowance based upon fourth quarter 2012 actual costs, times four, as shown at line
1024 6 of Schedule C-6, in place of the much larger PGL-proposed incremental expense
1025 allowance that is shown at line 7.

1026 **Q. How do PGL's actual monthly expenses for compliance with the new CDOT**
1027 **regulations compare to the proposed test year expense levels being**
1028 **recommended by the AG?**

1029 A. Using information provided in PGL’s response to Data Request AG 16.25,
1030 Attachment 3, the actual monthly expenses incurred by the Company to comply
1031 with the new CDOT regulations is as follows:
1032

1033 TABLE 3: ACTUAL CDOT COMPLIANCE EXPENSE TRENDS/COMPARISONS



1034
1035 The “Actually Incurred” expenses were nearly zero in July and August, but by
1036 October PGL was incurring about \$300 thousand per month in compliance costs.
1037 The horizontal line captioned “AG Proposed” represents the cost level being
1038 recommended for inclusion in the test year revenue requirement at this time. This
1039 reduced cost allowance is reasonable because it is consistent with the level of
1040 expenses PGL is actually incurring to comply with the referenced CDOT
1041 regulations at this time, rather than being based upon speculative estimates of
1042 potential worst case compliance costs. In contrast, the horizontal line captioned

1043 “PGL Estimated” is the compliance expense estimate sponsored by Mr. Hoops in
1044 Supplemental Direct Testimony that vastly exceeds PGLs actual spending to
1045 comply with the CDOT regulations to date in 2012.

1046 **Q. In his Rebuttal Testimony, did Mr. Hoops provide any analysis of PGL’s**
1047 **compliance efforts, actual compliance spending or any more detailed**
1048 **assessment of the impact of CDOT regulation changes?**

1049 A. No. Mr. Hoops Rebuttal on this topic is very limited and simply asserts that the
1050 Company’s forecasted compliance costs are “just and reasonable” and such costs
1051 are “prudent and reasonable” with no further analysis to support such claims.⁴⁵

1052 **Q. Are the much higher PGL-proposed expenses for compliance with new CDOT**
1053 **regulations known and measurable at this time?**

1054 A. No. The available documentation associated with PGL’s interaction with the City
1055 of Chicago in connection with the new CDOT regulations indicates considerable
1056 uncertainty regarding the scope, timing and ultimate expense that PGL will incur to
1057 maintain compliance. For example, the PGL response to Data Request AG 16.25,
1058 which I referenced above, contains a letter from PGL to a CDOT Commissioner
1059 dated November 14, 2012 in which the Company indicated that, “Peoples Gas is
1060 struggling with understanding certain changes and also needs time to make
1061 procedural changes to implement certain revisions.” Attachment B to that letter
1062 “details the more significant issues that Peoples Gas needs to discuss with CDOT
1063 and obtain clarity.” The questions raised in the attachment suggest a wide range of
1064 potential interpretations of certain of the regulations that would ultimately impact
1065 compliance cost levels, depending upon how issues are resolved. In other instances,

⁴⁵ NS-PGL Ex. 28.0, page 8.

1066 a “grace period” is proposed by PGL to allow for negotiations with contractors,
1067 presumably with a goal of reducing compliance costs. AG Exhibit 4.6 contains a
1068 copy of PGL’s response to Data Request AG 16.25.

1069 **Q. Given the level of expenses PGL actually incurred in the fourth quarter of**
1070 **2012 to achieve compliance with the CDOT regulations, does the Company**
1071 **expect to be in full compliance with such efforts?**

1072 A. Yes. The PGL response to AG 16.25, Attachment A, indicates a declining amount
1073 of citations were received by PGL in November and December of 2012 for
1074 violation of the new regulations. According to part (d) of the Company’s response,
1075 “Peoples Gas expects to be in full compliance with all new regulations by January
1076 1, 2013. The exception to this is code reference 5A (trench backfill material) for
1077 which Peoples Gas is awaiting clarification with the City of Chicago as referenced
1078 in PGL AG 16.25, Attach 02-question 6.”

1079 **Q. Turning next to the cross bores investigation expense issue, have you revised**
1080 **the adjustment appearing in AG Exhibit 4.1 and 4.2 at Schedule C-7 that**
1081 **previously had rejected estimated incremental expenses for both Companies’**
1082 **proposed new legacy “cross bores” investigation work?**

1083 A. I have not modified these adjustments. According to the Companies’ responses to
1084 Data Request AG 16.24, work has not started on any of the 91,000 PGL and 52,000
1085 NSG service pipes that were targeted for camera inspections. That same response
1086 indicates that only one of the eight new staff positions included in the Companies’
1087 cost estimates for support of this program has been filled at this time. It is simply
1088 not obvious that the Companies are committed to this effort and are convinced of

1089 any compelling and immediate need to start this work in the interest of public
1090 safety.

1091 **Q. What information and documentation should the Commission require before**
1092 **burdening ratepayers with additional expenses for the Companies' proposed**
1093 **cross bores investigation programs?**

1094 A. The Companies should be required to present a much more specific work plan that
1095 schedules the work, with documentation of the actual hiring of proposed new
1096 employees and contractual commitments to retain contractors at projected
1097 expenditures levels, so as to firm up the incremental proposed expenses for these
1098 efforts. Unless and until such specificity is provided by the Company that supports
1099 their estimates of cross bores investigation expenses, the Commission should reject
1100 the Company's proposed expense level.
1101

1102 **IX. AFFILIATE O&M EXPENSE ADJUSTMENTS.**
1103

1104 **Q. In Direct Testimony and AG Exhibits 1.3 and 1.4 at Schedule C-8, you**
1105 **proposed downward adjustments to several categories of Integrys Business**
1106 **Support ("IBS") billings to PGL and NSG where significantly higher**
1107 **forecasted test year charges above historical levels were proposed, because**
1108 **such increased expenses had not been adequately explained in the Companies'**
1109 **filing and responses to AG data requests. How did the Company respond to**
1110 **these adjustments in its Rebuttal?**

1111 A. Ms. Gregor states in her rebuttal, "I do not agree with Mr. Brosch's proposed
1112 adjustments to IBS costs, except for two minor adjustments." Ms. Gregor also

1113 indicates in rebuttal testimony that Peoples Gas’ responses to AG data requests
1114 12.12 through 12.20 and North Shore’s responses to AG data requests 12.1 through
1115 12.9, received by the AG after the filing of Staff and Intervenor Direct Testimony,
1116 provided additional information explaining the forecasted expense increases in each
1117 of the IBS home centers and that these explanations show that these costs are
1118 reasonable other than the two minor adjustments.⁴⁶

1119 **Q. What are the “two minor adjustments” that the Companies are now making in**
1120 **reaction to your proposed disallowances?**

1121 A. As explained in more detail by Ms. Gregor, the Companies now seek to remove the
1122 PGL and NSG shares of costs for \$250,000 of consulting fees in IBS home center
1123 AB2 and \$165,000 of software maintenance expenses that were “double booked” in
1124 estimating IBS test year expense levels.⁴⁷

1125 **Q. What information has Ms. Gregor provided for the other IBS charges to PGL**
1126 **and NSG that were challenged in your Direct Testimony?**

1127 A. No specific rebuttal testimony is offered for the unexplained variances in the IBS
1128 home centers listed in AG Exhibit 1.3 and 1.4 at Schedule C-8. Instead, Ms. Gregor
1129 attaches copies of responses made by the Companies to certain AG data requests
1130 within her NS-PGL Ex. 25.3P and NS-PGL Ex. 25.3N from which she claims that,
1131 “...additional information explaining the increases in each of the home centers was
1132 provided. These explanations show that these costs are reasonable other than the
1133 two minor adjustments.”

⁴⁶ NS-PGL Ex. 25.0, page 5, lines 92-102.

⁴⁷ Id. Lines 104-112.

1134 **Q. Have you revised your IBS home center adjustments that are set forth on**
1135 **Schedule C-8 after reviewing the Companies' responses to AG data requests,**
1136 **including those attached to Mr. Gregor's Rebuttal?**

1137 A. Yes. In some instances the additional information was sufficient to fully explain
1138 the proposed cost increases from IBS, while in other instances the additional
1139 information supports a revised adjustment amount or retention of the AG's original
1140 adjustment. I will explain the revisions set forth on each line of Schedule C-8 in
1141 AG Exhibits 4.1 and 4.2 for PGL and NSG, respectively, in the testimony that
1142 follows.

1143 **Q. Why have you now eliminated the adjustment you had proposed at line 1 of**
1144 **Schedule C-8 for IBS charges for information technology cost center A59**
1145 **charges to PGL and NSG?**

1146 A. This adjustment has been eliminated because of the software maintenance duplicate
1147 charges that have been corrected in the Companies' rebuttal revenue requirement
1148 calculation, as one of the two conceded adjustments discussed by Ms. Gregor, and
1149 because the explanations for the balance of higher charges from IBS home center
1150 A59 that were provided in response to data requests AG 12.12 and AG 13.18 are
1151 sufficient to justify the proposed higher costs.⁴⁸

1152 **Q. AG Exhibit 4.1 and 4.2, Schedule C-8 also now reflects elimination of your**
1153 **adjustment on line 2 to exclude the "unexplained variance" amount associated**
1154 **with test year estimated charges from IBS for the "Safety Health and**

⁴⁸ PGL's Response to data request AG 12.12 is contained in the first four pages of NS-PGL Ex. 25.3P. PGL's response to AG 13.18 explains and quantifies the downward adjustment to software maintenance charges conceded by the Companies in rebuttal.

1155 **Wellness” home center A45. Why have you now accepted as reasonable these**
1156 **higher test year estimated charges?**

1157 A. Considerable additional detailed supporting information was provided in the
1158 Companies’ response to data requests AG 12.14 and AG 13.12 explaining the
1159 Integrys wellness program initiatives and expected benefits to the Companies from
1160 these efforts.⁴⁹ Upon review of these materials, I believe that the Companies have
1161 justified these charges. Reduced workers’ compensation costs and other indirect
1162 benefits from reduced employee health benefit expenses in future years should
1163 provide a payback on these incremental costs planned to be incurred in the test year.

1164 **Q. For what reasons have you revised the adjustment at Schedule C-8, line 3, that**
1165 **is applicable to IBS home center A06 for Corporate Controller allocated costs?**

1166 A. IBS Corporate Controller charges were the subject of additional inquiry in data
1167 requests AG 12.13 and AG 13.11, and an itemized breakdown of historical expense
1168 by vendor was provided by the Companies. Corporate Controller IBS actual
1169 payments to vendors in 2011 totaled \$3.3 million and in the 10 months ending
1170 October 31, 2012 totaled \$2.6 million, but in the forecasted test year about \$5.0
1171 million of payments to vendors by IBS is forecasted. This comparison illustrates
1172 the apparent overstatement of total estimated vendor charges for services to the IBS
1173 Corporate Controller organization, prior to allocations among Integrys affiliates.
1174 Additionally, the itemization of IBS Corporate Controller forecasted 2013 expenses
1175 includes more than \$1 million for International Financial Reporting Standards
1176 (“IFRS”) consulting work in 2013 that is highly speculative, and \$140,000 for
1177 potential acquisition and merger-related services that are also speculative and, as

⁴⁹ A copy of PGL’s response to AG 12.14 is included in NS-PGL Ex. 15.3P.

such, should not be charged to the regulated utilities in Illinois if actually incurred by IBS. I have included a copy of the PGL responses to data request AG 13.11 and AG 12.02 with excerpts of Attachments 1 within AG Exhibit 4.7 to support these conclusions. Footnote (c) on Schedule C-8 explains a revised adjustment for IBS Corporate Controller forecasted expenses that would reduce such charges to an allocated PGL/NSG share of actual vendor charges for the year-to-date October 2012 period, times 12/10 months to annualize the amounts.

Q. Why have you now eliminated the adjustments previously proposed at lines 4 through 7 of AG Exhibits 4.1 and 4.2, Schedule C-8?

A. Upon review of additional supporting information supplied by the Companies in response to various AG data requests, I have concluded that the estimated IBS charges for which variances were previously unexplained are now sufficiently documented and appear reasonable, as indicated in footnotes (b) and (d). For IBS Utility Group Executive Office allocated charges at line 5 of Schedule C-8, the adjustment now included by the Companies in rebuttal to reduce forecasted consulting fees⁵⁰ is an additional reason why the AG-proposed adjustment for this element of IBS allocated costs is no longer necessary.

Q. Please explain why your initially proposed adjustment to reduce IBS legal charges to the Companies, at line 8 of Schedule C-8, has not been revised.

A. The information provided by the Companies in response to data requests AG 12.19 and AG 13.16 supports a conclusion that legal fees in total have been overstated in the 2013 forecast prepared for the IBS Legal cost center. This overstatement can be observed in comparisons of forecasted 2013 amounts to recorded 2010, 2011 and

⁵⁰ See NS-PGL Ex. 25, page 5, line 104 and NS-PGL Ex. 25.4.

1201 year-to-date 2012 spending in the Companies' response to AG 12.08 and 12.19
1202 within Ms. Gregor's NS-PGL Ex. 25.3P at Bates PGL 0018659 through PGL
1203 0018661. A more detailed breakdown of recorded historical legal fees, forecasting
1204 assumptions and calculations supportive of test year IBS Legal forecasted expenses
1205 was requested in data request AG 13.16 to assist in the analysis of forecasted
1206 spending levels, but the Companies objected to providing additional breakdowns
1207 and did not provide any additional support for the proposed forecasted 2013
1208 expense levels. I have included a copy of the response to data request AG 13.16
1209 within AG Exhibit 4.8.

1210 **Q. What is the reason for your revised adjustment for IBS depreciation expense**
1211 **at line 9 of AG Schedule C-8?**

1212 A. IBS allocated charges to PGL and NSG include depreciation and amortization
1213 expense for assets employed by IBS to provide services to its affiliated companies.
1214 My analysis of IBS depreciation amounts forecasted for the 2013 test year indicated
1215 unreasonably large increases in projected amounts allocable to PGL and NSG. An
1216 adjustment was proposed in my Direct Testimony based upon the overall
1217 unexplained variance for such increased charges within the response to data request
1218 AG 3.14. Additional information provided by the Companies in response to AG
1219 data requests indicates the need for a more specific adjustment than appeared in my
1220 Direct Testimony for IBS depreciation, which is set forth in footnote (f) of Schedule
1221 C-8. This more specific adjustment is to update depreciation charges for the
1222 updated in-service date expected to be achieved in June of 2013 for the GAP
1223 software development project to improve the Work Asset Management ("WAM")
1224 System, as more fully explained in the Companies' response to data request AG

12.20.⁵¹ Additional follow-up discussion of the WAM GAP project was provided in the response to AG 13.10, which I have included within AG Exhibit 4.9. According to the response to AG 13.10(d)(xi), “The WAM GAP project will be in service in June, 2013. Updated depreciation numbers will be reflected in surrebuttal.” The revised AG adjustment at line 9 of Schedule C-8 is needed to replace the full year of WAM GAP depreciation with a half-year of such depreciation based upon an assumed mid-year in service date for the project.

Q. In Direct Testimony, you sponsored an adjustment to update the IBS return on investment at AG Exhibits 1.3 and 1.4, Schedule C-9. Have you now revised that adjustment?

A. Yes. The Companies’ Rebuttal Testimony indicates that PGL and NSG do not contest making an adjustment to update the IBS return on investment charges that appear within the Utilities’ operating expenses.⁵² However, the Companies’ adjustment for this purpose is tied to the level of return on investment most recently awarded by the Commission in Dockets 11-0280 and 11-0281, rather than the updated rates of return being proposed by the AG in Schedule D. In AG Exhibits 4.1 and 4.2, I continue to update the IBS return on investment expense amounts as proposed in my Direct Testimony, but have added a line 11 amount to account for the incremental adjustment now being made by the Companies that revises the IBS return levels to the Companies’ previously authorized overall return levels.

⁵¹ This response is included in NS-PGL Ex. 25.3, at Bates PGL 0018429 through PGL 0018582.
⁵² NS-PGL Ex. 26.0, page 5, line 107.

X. CASH WORKING CAPITAL.

Q. In his Rebuttal, Mr. Hengtgen states that your assignment of a zero revenue lag day value for pass-through taxes is “incorrect and illogical” and that no “analysis or quantitative support” for doing so has been provided by either you or Staff witness Mr. Kahle.⁵³ Are these claims valid?

A. No. The assignment of a zero revenue lag day value is entirely correct and quite logical because these taxes are incurred because of, and at the time of, the collection of taxable revenues by the Companies. This was explained in my Direct Testimony along with citations to the relevant statutes and municipal codes⁵⁴ and has been found to be true by the Commission in its recent rate Orders.⁵⁵ There is no need for “analysis or quantitative support” for utilization of zero revenue lag days because of the fact that pass-through taxes become payable when revenues have been collected by the Companies.

Q. Has Mr. Hengtgen admitted that pass through taxes, with the exception of the ICC Gas Revenue Tax, are due and payable upon (or after) collection, as asserted by you and Staff witness Kahle?

A. Yes. In response to Data Request PGL 16.21, the Companies stated, “Mr. Hengtgen agrees and does not have to assume that for the pass through taxes listed on NS-PGL ex. 27.13P and 27.13N, with the exception of the ICC Gas Revenue Tax, the amounts are due and payable upon (or after) collection. These facts have been discussed and identified in Mr. Hengtgen’s direct testimony and rebuttal testimony

⁵³ NS-PGL Ex. 27.0, page 15, lines 324-329.

⁵⁴ AG Ex. 1.0, page 53.

⁵⁵

1269 and are clearly presented in its lead lag study, WPB-8. However, Mr. Hengtgen
1270 cannot assume that ‘no revenue lag is applicable’. There is a cash inflow of these
1271 funds to the Utilities, therefore there is a lag and it is identical to the lag as
1272 explained in Mr. Hengtgen’s direct and rebuttal testimonies. Therefore, no
1273 modifications to the Utilities’ lead day values can be calculated and is not
1274 required.” I have included a copy of this response in AG Exhibit 4.10, along with
1275 copies of the relevant pages from the referenced WPB-8 that were used by Mr.
1276 Hengtgen to calculate the pass through tax payment lead day values.

1277 **Q. Have you adopted and used Mr. Hengtgen’s calculated pass through tax lead**
1278 **day values in calculating cash working capital in this Docket?**

1279 A. Yes. It is my understanding that Staff witness Mr. Kahle also used the Companies’
1280 pass through tax lead day values. After reading Mr. Hengtgen’s rebuttal testimony,
1281 it appears that he continues to support the payment lead day values he sponsored in
1282 direct testimony, while mysteriously concluding that assignment of a zero revenue
1283 lag to the related customer remittances within the AG and Staff lead/lag
1284 adjustments makes Mr. Hengtgen’s payment lead day values for these taxes
1285 suddenly become unreasonable and illogical.

1286 **Q. Are the lead day values that were calculated by Mr. Hengtgen reasonable for**
1287 **use by you and by Staff in calculating the Companies’ cash working capital for**
1288 **the test year?**

1289 A. Yes. The calculations shown on the Companies’ WPB-8 for pass-through taxes
1290 clearly show that specific revenue “collection assumptions” were used to calculate
1291 the total amounts of taxes actually paid for each month of 2011. These workpapers

1292 reflect that actual taxes paid by PGL each month relate to revenues billed in the
1293 current “service month” as well as revenues earned in three prior months, which are
1294 designated “Service Month +1”, “Service Month +2” and “Service Month +3” in
1295 the workpapers. This fact causes PGL to experience longer lead days for pass
1296 through taxes than other Illinois utilities, which allows the Company to hold the
1297 cash for these pass through taxes longer than would appear to be possible under the
1298 applicable statutory payment due dates for such taxes.

1299 **Q. Has Mr. Hentgen included new exhibits 12.12P and 12.12N with his rebuttal**
1300 **testimony for the apparent purpose of characterizing your (and Staff’s)**
1301 **reliance upon the Companies’ calculated pass through tax lead day values to**
1302 **be unreasonable and illogical?**

1303 A. Yes. Mr. Hengtgen explains that his NS-PGL Ex. 27.12P shows the possible
1304 collection and due dates for Peoples Gas’ Gross Receipts/Municipal Utility Tax
1305 (“MUT”), the City of Chicago Gas Use Tax (“City GUT”), the Energy Assistance
1306 Charges (“EAC”) and the Gross Revenue/Public Utility Tax (“GRT”), stating “for
1307 an example month (September 2012) and when the amounts would be due based on
1308 all the possible collection dates in the example month.” Mr. Hengtgen then
1309 concludes with what he calls a “side by side comparison” of the Company’s
1310 calculated lead day values compared to the maximum and average number of “days
1311 held” with columns showing calculations of “Days Staff and AG Proposal Exceeds”
1312 the “Max” and “Average” of the “Days Held” derived by Mr. Hengtgen from his
1313 exhibits NS-PGL 27.12P.

1314 **Q. Given that you and Staff have adopted Mr. Hengtgen’s calculated payment**
1315 **lead day values for pass through taxes, is it unusual for Mr. Hengtgen to now**
1316 **offer a rebuttal calculation to prove that the Companies’ own payment lead**
1317 **days for pass through taxes are unreasonable?**

1318 A. Yes. Either Mr. Hengtgen’s asserted pass through tax payment lead days are
1319 reasonable, or they are not. How and when the Utilities pay pass through taxes is a
1320 factual determination without regard to measurement and application of revenue lag
1321 days to the related cash inflows. It would appear that Mr. Hengtgen is now
1322 attempting in rebuttal to disparage his own calculated payment lead day values for
1323 pass through taxes, in an effort to somehow rationalize applying a full revenue lag
1324 to the related cash inflows. Mr. Hengtgen’s calculations in PGL WPB-8 reveal an
1325 important difference in the timing of the Companies’ actual tax remittance
1326 payments that is completely inconsistent with the assumptions now being used by
1327 Mr. Hengtgen in his rebuttal NS-PGL Ex. 27.12P.

1328 **Q. Does PGL actually pay pass through City of Chicago Gas Use Tax revenues**
1329 **pursuant to the “Day Collected” and “Due Date” periods shown in NS-PGL**
1330 **Ex. 27.12P?**

1331 A. No. Actual monthly payments are based upon 25% of the current month’s
1332 revenues, plus 50% of the prior month’s revenues, plus 15% of the revenues from
1333 the month before the prior month, plus 10% of the revenues from the third prior
1334 month, as shown in PGL WPB-8 for “Taxes-Pass Through-Chicago Gas Use Tax”
1335 and not the “Number of Days Held” as shown in rebuttal NS-PGL Ex. 27.12P. Mr.
1336 Hengtgen’s rebuttal exhibit displays hypothetical payment patterns that are vastly
1337 different from the Company’s actual remittance patterns shown in its lead lag study

1338 workpapers. The same inconsistency exists for the “Energy Assistance Charges” in
1339 NS-PGL Ex. 27.1P when compared to the “Taxes-Pass Through-EAC” analysis of
1340 actual payments in PGL WPB-8, and for “Public Utility Tax” in NS-PGL Ex. 27.1P
1341 when compared to the “Taxes-Pass Through-GRT/MUT” actual payments analyzed
1342 in PGL WPB-8.

1343 **Q. Should the Commission rely upon the payment lead day values sponsored by**
1344 **Mr. Hengtgen in his direct testimony and calculated in WPB-8 for the timing**
1345 **of payments of pass through taxes?**

1346 A. Yes. The payment lead day values from Mr. Hengtgen’s work in WPB-8 should be
1347 utilized, because the “Collection Assumptions” used therein are reflective of
1348 agreements made with the City of Chicago that the Companies have apparently now
1349 adopted to delay remittances of other types of pass through taxes. This distinction
1350 is referenced in Mr. Hengtgen’s Rebuttal where he states:

1351
1352 As I referred to in my direct testimony (PGL Ex. 7.0, line 603),
1353 Peoples Gas has an agreement (PGL Ex. 7.3) with the City of
1354 Chicago (“City”), which governs how these taxes are paid. In
1355 accordance with that agreement, Peoples Gas pays and remits the
1356 MUT and the City GUT on the basis of estimated cash receipts
1357 *regardless* of whether or not the amounts are received from
1358 customers. The estimated cash receipt percentages are based on a
1359 four-month collection period as identified on page 2 of the
1360 agreement. *See* PGL Ex. 7.3. I have used these collection
1361 percentages in my lead lag study (WPB-8, pages 45-56) in order to
1362 properly reflect the lead values as proposed by Peoples Gas.
1363 Because the agreement with the City requires the use of fixed
1364 estimated collection percentages and those percentages more than
1365 likely will differ from actual collections of these amounts from
1366 customers, the days held amount will not reflect the averages
1367 shown on NS-PGL. Ex. 27.12P. After the agreement with the City
1368 was implemented, Peoples Gas decided to use a similar process for
1369 the GRT and the EAC. North Shore also follows this process for
1370 all of its pass through taxes with the exception of the ICC Gas
1371 Revenue Tax. All of this information is clearly laid out in the

1372 Utilities' WPB-8 on pages 45-56 for Peoples Gas and pages 28-49
1373 for North Shore.⁵⁶
1374

1375 Mr. Hengtgen should not be allowed to characterize the pass through tax
1376 "Due Dates" differently in rebuttal NS-PGL Ex. 27.1N/P so as to criticize
1377 Staff and AG, when the negotiated payment due dates that are actually
1378 employed by the Companies are much more liberal and allow more delay in
1379 tax remittances, as reflected in the referenced PGL and NSG WPB-8
1380 calculations.

1381 **Q. After review of Mr. Hengtgen's Rebuttal, have you identified any needed**
1382 **revisions to the AG lead lag study of cash working capital?**

1383 A. Yes. In his rebuttal, Mr. Hengtgen states that the ICC Gas Revenue Tax is,
1384 "Different than the other pass through taxes, the ICC Gas Revenue Tax is not based
1385 on collections but 'equal to .08% of its gross revenue for each calendar year' (220
1386 ILCS 539 5/2-202 (c))."⁵⁷ I agree with this distinction and have reclassified this tax
1387 expense in AG Exhibit 4.1 and 4.2 near the bottom of Schedule B-5 so that it is no
1388 longer treated as a pass-through tax at lines 1 and 2. Except for this revision, I
1389 stand by and do not propose any modifications to my CWC adjustments described
1390 and detailed in my Direct Testimony.

1391 **Q. Mr. Hengtgen challenges your use of the term "lag" versus "lead" in his**
1392 **rebuttal, stating, "While this may seem like a minor technical point, it may be**
1393 **a part of the reason this issue is being contested and is confusing to people that**
1394 **are not familiar with 1) a lead lag study, 2) pass through taxes generally, and 3)**
1395 **how these cash flows (inflows and outflows) work." How do you respond?**

⁵⁶ Id. page 22, lines 479-494.

⁵⁷ Id. Page 25, line 537.

1396 A. Mr. Hengtgen’s suggestion that I am somehow confused is unfortunate and
1397 unproductive. I have worked with lead lag studies in multiple regulatory
1398 jurisdictions for more than three decades and know that the terms “lag” and “lead”
1399 can and frequently are used interchangeably by informed practitioners to reference
1400 the time difference between dates when earning or incurring a revenue or cost and
1401 the related dates of cash receipt/payment for same. I have adopted Mr. Hengtgen’s
1402 preferred terminology in this rebuttal in an effort to reduce any perceived
1403 “confusion” surrounding this matter of semantics.

1404 **Q. Mr. Hengtgen states in rebuttal, “Messrs. Kahle’s and Brosch’s argument that**
1405 **the Utilities are only “collection agents” is a red herring in two respects. First,**
1406 **if the lag (cash inflows) is zero, in other words there are no cash inflows or**
1407 **collections of this tax from the customers, it is illogical to assume that there**
1408 **would be cash outflows at all and there would be no impact on CWC. Second,**
1409 **the argument ignores the fact that the Utilities still require cash on hand to pay**
1410 **the tax by the due date. If not all collections are received by customers,**
1411 **shareholders are financing the payment until funds are collected.”⁵⁸ How do**
1412 **you respond?**

1413 A. It is quite “logical” for utilities to serve as collection agents for pass through taxes
1414 through tariff Rider 1, as I explained in my Direct Testimony.⁵⁹ I would note that
1415 Mr. Hengtgen’s own PGL Ex. 7.3 is captioned as an “Amendment to Tax
1416 Collection Agreement” with the City of Chicago and the Companies’ WPB-8
1417 workpapers employ “Collection Assumptions” in order to calculate the relevant
1418 payment lead days for pass through taxes. In the context of ICC Gas Revenue Tax,

⁵⁸ Id. Page 25, line 544.

⁵⁹ AG Ex. 1.0, page 53, lines 1196-1202.

1419 where Mr. Hengtgen chose to dispute my “collection agent” characterization, any
1420 differences in the ratemaking treatment of cash flows has been eliminated by the
1421 modifications made to the AG calculation of cash working capital on Schedule B-5.

1422 **Q. In your review of documents associated with the Companies’ treatment of pass**
1423 **through taxes, have you identified another reason why the collection of such**
1424 **taxes should not be assigned a revenue lag as proposed by PGL?**

1425 A. Yes. In PGL’s response to data request AG 7.34, Attachment 8 includes a copy of
1426 the Gas Use Tax Form – 7574 that is used to calculate and remit this tax. Page 1 of
1427 this Attachment 8 indicates that PGL retained a “commission amount of
1428 \$911,147.88” that appears to provide compensation to the utility for “Timely
1429 Payments” of such tax. The Company should be required to explain and quantify in
1430 its surrebuttal testimony all retained commission income that it receives when
1431 acting as a collection agent for City of Chicago or for other pass through taxes,
1432 indicating whether such commission amounts have been included in forecasted test
1433 year other revenues to reduce the asserted revenue requirement, or are instead being
1434 retained for the sole benefit of shareholders. I have included a copy of PGL’s
1435 response to AG 7.34 with only Attachment 8 in AG Exhibit 4.11.

1436 **Q. Mr. Hengtgen also disputes your application of the other operations and**
1437 **maintenance expense lead day value in place of the irregular schedule**
1438 **payments for pension and OPEB that were used by the Companies stating,**
1439 **“There is nothing routine about the cash flow related to the Utilities Pension**
1440 **and OPEB expenses. Mr. Brosch even indicated in his testimony that the**
1441 **Utilities had supplied data in response to a staff data request reflecting**

1442 **irregular scheduled payments for pension and OPEB.”⁶⁰ Can you clarify the**
1443 **basis for your proposal?**

1444 A. Yes. I explained in my direct testimony that PGL and NSG had arbitrarily assumed
1445 a zero payment lead day value for pension and OPEB expenses, as if there is no
1446 cash flow related to pension and OPEB expenses, causing an overstatement of cash
1447 working capital because a positive revenue lag was assigned by PGL/NSG with no
1448 corresponding expense payment lead.⁶¹ In response to Staff data request DGK 5.02,
1449 the Companies provided information showing a single pension funding for North
1450 Shore Gas in January of 2011 and no pension funding payments in 2011 for PGL.
1451 With regard to OPEB expense, the same response provided OPEB funding
1452 payments that were front-loaded in February of 2011. Using this data and assuming
1453 a calendar year analysis period would produce an exceptionally large apparent
1454 prepayment of OPEB and pension expenses for NSG, and a meaningless pension
1455 lead day value for PGL since no PGL pension funding occurred. This irregular
1456 pattern of payment timing was not relied upon by Mr. Hengtgen in his rebuttal
1457 calculation of CWC in NS-PGL Ex. 27.10P/N and is not reliable enough for use in
1458 the AG’s calculation of CWC. A more normal pattern of cash disbursements is
1459 reflected in the Companies’ analysis of miscellaneous expense payments for the line
1460 item captioned “Other Operations and Maintenance” in its lead lag study. Rather
1461 than accepting Mr. Hengtgen’s arbitrarily assumed zero payment lag for pension
1462 and OPEB expenses, I recommended the Other O&M lead day timing as indicative
1463 of the Companies’ normal payment patterns for routine cash disbursements.

⁶⁰ NS-PGL Ex. 27.0, page 30, line 652.

⁶¹ AG Ex. 1.0, page 54, line 1222 to page 55, line 1252.

1464 Accordingly, the Commission should adopt my adjustment, detailed in my Direct
1465 testimony and in AG Ex. 4.1 and 4.2 at Schedule B-5, line 8, in column C.

1466

1467 **XI. COST OF CAPITAL.**

1468

1469 **Q. In AG Exhibits 4.1 and 4.2, have you revised Cost of Capital Schedule D from**
1470 **the amounts previously included in AG Exhibits 1.3 and 1.4, Schedule D?**

1471 A. I have updated Schedule D to reflect, at lines 1 through 4, the revisions to capital
1472 balances and cost rates that are now reflected in the Companies' Rebuttal testimony
1473 and exhibits. Lines 5 through 8 adopt the Companies' revised capital balances and
1474 ratios, but retain the lower cost of long term debt and common equity that were
1475 propsoed and explained in my Direct Testimony.

1476 **Q. Why are the Companies' proposed costs of long term debt higher than the cost**
1477 **rates proposed by the AG?**

1478 A. The Companies' assumed cost rates for newly issued long term debt are higher than
1479 the rates assumed in the AG-proposed cost of long term debt for several reasons
1480 that can be observed in NS-PGL Ex. 23.3P/N that is sponsored by Ms. Gast:

- 1481 • For PGL, a "New Issue" of \$100 million of long term debt on 11/01/12 at
1482 an estimated cost rate of 4.03% is recognized, even though this debt
1483 issuance actually occurred at a final coupon rate of 3.98%.⁶²
1484 • For PGL, a second "New Issue" of \$200 million of long term debt on
1485 9/01/13 at an estimated cost rate of 4.03% is recognized, at an estimated

⁶² See AG Exhibit 1.12 at page 6. PGL stated in response to AG 16.04c, "The 4.05% new issue cost rate is an estimated rate. Due to an unintentional oversight, the rate was not updated with the actual known rate in rebuttal testimony. The actual rate associated with the new long-term debt issuance Series YY is 3.98% as Mr. Brosch notes from Integrys' third quarter 2012 Form 10Q... The Company will update in surrebuttal testimony to reflect the updated long-term cost rate."

1486 coupon rate of 4.45%. This cost rate is higher than current capital market
1487 cost rates.

1488 • For NSG, a “New Issue” of \$55 million of long term debt on 5/01/13 at an
1489 estimated cost rate of 4.20% is recognized. This cost rate is higher than
1490 current capital market cost rates.

1491 In contrast, the AG is recommending a slightly lower overall cost of long term
1492 debt. In AG Exhibit 4.1 and 4.2, at Schedule D, I have retained the same overall
1493 cost of long term debt that was described in my Direct Testimony. Each of the
1494 planned new issuances of long term debt are included at the same 3.98% cost rate
1495 that was recently incurred by PGL to issue \$100 million of new debt closing just
1496 last month. This percentage amount, unlike the Companies’ assumed higher
1497 percentage rates, is based on the Companies’ own recent borrowing experience and
1498 more fairly represents actual long term debt costs.

1499

1500 **Q. What reasons are given by the Companies for ignoring the 3.98 percent coupon**
1501 **cost rate that was actually incurred by PGL to issue \$100 million of long term**
1502 **debt closing in December of 2012, in favor of higher forecasted costs of newly**
1503 **issued long term debt in 2013?**

1504 A. According to Ms. Gast, “Historical rates reflect the historical economic
1505 environment. Worse, historical spot-day rates reflect only the economic conditions
1506 that prevailed on a single day in the past. Using historical rates to set rates for a
1507 future test year assumes that the historical interest rate environment will continue
1508 through the test year. By contrast, interest rates forecasts take into account the
1509 economic conditions that are expected to prevail during the test year. The

1510 Commission should not base the Utilities' rates on inferior information when better
1511 information is available."⁶³

1512 **Q. Is the actual cost rate experienced by PGL to issue debt just last month**
1513 **"inferior information" relative to third party forecasts of debt cost rates that**
1514 **may exist only a few months later in 2013?**

1515 A. No. The best available information is the actual cost to issue long term debt
1516 recently incurred by the Companies.

1517 **Q. According to Ms. Gast, "Moody's forecast anticipates that current economic**
1518 **and fiscal conditions will continue to persist into 2013 even though their**
1519 **forecast of U.S. Treasury yields is increasing. This directly conflicts with Mr.**
1520 **Brosch's assertion that rates will remain as they are currently since the**
1521 **Federal Reserve intends on maintaining its accommodative monetary policy.**
1522 **While Mr. Brosch bases his rate conclusion on monetary policy only, Moody's**
1523 **DataBuffet.com bases its forecast on its assessment of not only monetary policy**
1524 **but also fiscal policy, the U.S. dollar, and energy prices.**⁶⁴ **How do you**
1525 **respond?**

1526 A. I disagree with Ms. Gast's view that "forecasts are the best information we have"⁶⁵
1527 when we can easily look to actual debt issuance yields experienced by PGL just last
1528 month to determine probable debt costs for new issuances in the near future. The
1529 recent variability of the Companies' interest rate forecast data indicates the risk to
1530 ratepayers arising from use of such forecasts when actual cost data is readily
1531 available. In only a few months that passed between the time the Companies

⁶³ NS-PGL Ex. 23.0, page 7, line 144.

⁶⁴ Id, page 8, line 153.

⁶⁵ Id. line 162.

prepared their direct testimony and their rebuttal testimony, forecasted cost rates for new long term debt have declined significantly. The May 2013 new debt issuance planned by NSG was estimated to cost 4.75% in the Company's direct filing, and this forecast has now declined to 4.20% in NSG's rebuttal.⁶⁶ Similarly, the September 2013 new issuance planned by NSG was estimated to cost 4.95% in the Company's direct filing and this forecasted cost rate has now declined to 4.45% in NSG's rebuttal.⁶⁷ Given the extremely low current interest rate environment, it is understandable that debt cost forecasts would tend toward an expectation of higher future interest rates, only to be followed by downward revisions when updates are required to reflect continuation of the current environment. This tendency should not serve as a basis to overstate the cost of new issuances of long term debt scheduled to occur within the next eight months.

Q. With regard to cost of equity, Ms. Gast states, "If Mr. Brosch is recommending that the Commission authorize an ROE consistent with recent findings, a 9.87% ROE is even more consistent with that recommendation."⁶⁸ Is that what you are recommending?

A. No. An accurate reading of my direct testimony would show that I have not independently quantified an appropriate return on equity for the Companies and that "[t]he 9.45 percent ROE found reasonable by the Commission earlier this year for PGL and NSG is consistent with the recent ROE findings for gas distribution utilities that I have observed in other state commission rate orders."⁶⁹ If I had

⁶⁶ NS Ex. 2.3, Schedule D-3 at line 27 versus NS-PGL Ex. 23.3N at line 3.

⁶⁷ PGL Ex. 2.3, Schedule D-3 at line 13 versus NS-PGL Ex. 23.3P at line 13.

⁶⁸ NS-PGL Ex. 23, page 11, line 228.

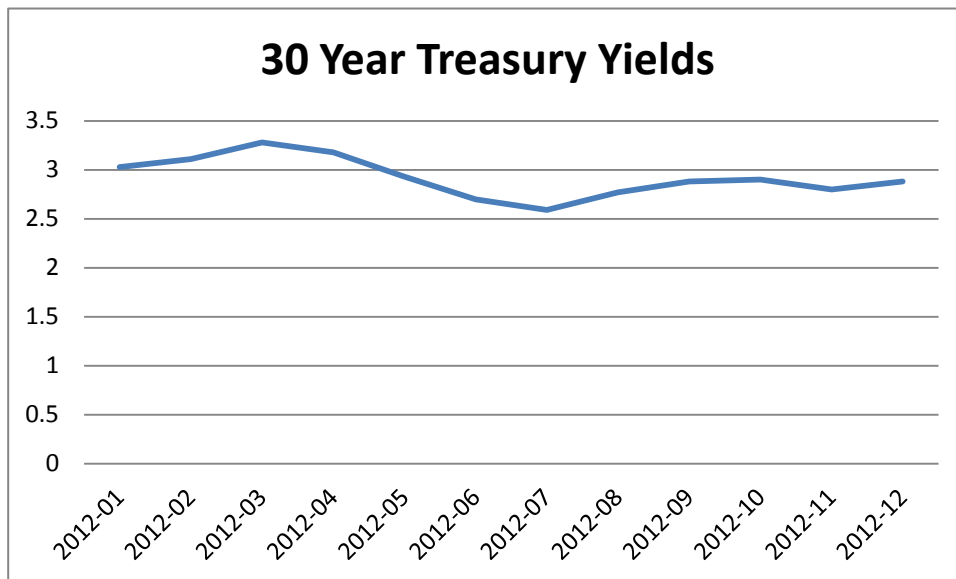
⁶⁹ AG Ex. 1.0, page 61, line 1378.

actually relied upon any survey data or conducted any independent analysis, the result may have been higher or lower than 9.45 percent.

Q. What has been the trend in risk free interest rates since the test year in Docket Nos. 11-0280/0281 consolidated, when the currently authorized ROE of 9.45 was established for the Companies?

A. Risk free long term interest rates, using the market yield on U.S. Treasury securities at 30-year constant maturity reported by the Federal Reserve Board, have declined slightly since the date of the Commission’s Final Order in the prior rate cases, as depicted in the following table:

TABLE 4: RISK FREE INTEREST RATES SINCE PRIOR RATE ORDER



Source: <http://www.federalreserve.gov/releases/h15/data.htm> (30-year Treasury selected)

If one were to employ a risk premium approach to updating the allowed ROE, a somewhat lower return is required today than was allowed by the Commission in the prior rate cases, contrary to Ms. Gast’s assertions.

XII. CONCLUSION AND RECOMMENDATION.

1570
1571

1572 **Q. What is your recommendation regarding the revenue requirement to be**
1573 **determined for Peoples Gas Light and Coke Company?**

1574 A. I recommend that PGL's revenue requirement be found to be no larger than the
1575 amount shown in AG Exhibit 4.1, at Schedule A, column D, line 7. This amount
1576 should be further modified for any Commission-approved ratemaking adjustments
1577 proposed by the Staff and other parties, that are not addressed in my or Mr. Effron's
1578 Rebuttal Testimony.

1579 **Q. What is your recommendation regarding the initial revenue requirement to be**
1580 **determined for North Shore Gas Company?**

1581 A. I recommend that PGL's revenue requirement be found to be no larger than the
1582 amount shown in AG Exhibit 4.2, at Schedule A, column D, line 7. This amount
1583 should be further modified for any Commission-approved ratemaking adjustments
1584 proposed by the Staff and other parties, that are not addressed in my or Mr. Effron's
1585 Direct Testimony.

1586 **Q. Do AG Exhibits 4.1 and 4.2 also include the impact of adjustments being**
1587 **proposed by Mr. Effron?**

1588 A. Yes. An index appearing at page one of each Exhibit lists the Schedules contained
1589 therein and indicates the sponsoring witness for each adjustment, including each of
1590 the individual adjustments to rate base and operating income that are being
1591 supported by Mr. Effron.

1592 **Q. Does this conclude your testimony at this time?**

1593 A. Yes.